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8-10-75

United States

Circuit Court of Appeals

For the Ninth Circuit.

Vol
2338

SAN FRANCISCO LAUNDRY ASSOCIATION,
a corporation,

Appellant,

vs.

AMERICAN TRUST COMPANY,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United
States for the Northern District of California,
Southern Division.

FILED

JAN - 7 1942

PAUL P. O'BRIEN,
CLERK

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No. 9985

United States
Circuit Court of Appeals

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	Page
Affidavit as to Amount Involved in Appeal.....	111
Affidavit of Charles M. Bufford in Support of Motion to Amend Decree Disapproving Plan of Reorganization and Dismissing Proceed- ing	105
Answer of American Trust Co. to Petition for Reorganization	20
Appeal:	
Designation of Appellant of Contents of Record on	134
Designation of Appellee of Contents of Record on	141
Notice of	110
Statement of Points on (Circuit Court of Appeals)	134
Statement of Points on (District Court).....	132
Attorneys, Names and Addresses of	1
Certificate and Report of Special Master on Is- sues Raised by Answer to Petition for Cor- porate Reorganization and Objections to Pro- posed Plan of Reorganization	1

Index	Page
Certificate of Clerk	132
Designation of Record on Appeal of Appellant..	134
Designation of Record on Appeal of Appellee.....	141
Exceptions of Debtor to Certificate and Report of Special Master	100
Names and Addresses of Attorneys	1
Notice of Appeal	110
Notice of Motion to Amend Decree Disapprov- ing of Plan of Reorganization and Dismissing Proceeding	104
Objections of American Trust Co. to Proposed Plan of Reorganization	77
Order Approving Petition as Properly Filed, etc.	13
Order Denying Motion to Amend Order Disap- proving Proposed Plan and Dismissing Pro- ceeding, entered Sept. 12, 1941	109
Order Disapproving Reorganization Plan, Dis- missing Proceedings, and Allowing Certain Fees, etc.	103
Order Extending Time to File Plan of Reor- ganization and Referring Debtor's Petition and Answer to Special Master	27
Order of Reference of Issues Raised by Objec- tions of American Trust Co. to Proposed Plan of Reorganization to Special Master	78

Index	Page
Petition of Debtor for Corporate Reorganiza- tion	2
Proposed Plan of Reorganization of Debtor.....	61
Restraining Order	12
Statement of Points on Which Appellant In- tends to Rely (Circuit Court of Appeals)	134
Statement of Points on Which Appellant In- tends to Rely (District Court)	112
Testimony:	
On Petition for Reorganization.....	28
Witnesses for debtor:	
Ahnefeld, Edward	
—direct	32
—cross	34
—redirect	36
Banker, B. A.	
—direct	30
Bufford, Charles M.	
—direct	36
—cross	41
—redirect	42
—recalled, direct	44
—cross	56
Thomas, George H., Jr.	
—direct	28
—cross	29

Index	Page
On Proposed Plan of Reorganization and Objections Thereto	79
Witness for debtor:	
Bufford, Charles M.	
—direct	91
Testimony, Statement in Narrative Form of.....	116
Witnesses for debtor:	
Ahnefeld, Edward	123
Banker, B. A.....	121
Bufford, Charles M.	124
Thomas, George H., Jr.	118
Transcript of Hearings before Special Master on Petition for Reorganization and the An- swer Thereto (See “Testimony”)	28
Transcript of Hearings before Special Master on Proposed Plan of Reorganization and the Objections Thereto (See “Testimony”)	79

NAMES AND ADDRESSES OF ATTORNEYS

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Attorney for Appellant.

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Attorneys for Appellee.

In the Southern Division of the United States
District Court for the Northern District of
California.

No. 33553-L

Bankruptcy, Chapter X

In the Matter of

SAN FRANCISCO LAUNDRY ASSOCIATION,
a corporation,

Debtor.

CERTIFICATE AND REPORT OF SPECIAL
MASTER ON ISSUES RAISED BY AN-
SWER OF AMERICAN TRUST COMPANY
TO PETITION FOR CORPORATE RE-
ORGANIZATION AND OBJECTIONS OF
AMERICAN TRUST COMPANY TO PRO-
POSED PLAN OF REORGANIZATION

To Honorable Harold Louderback, United States
District Judge for the Northern District of
California:

I, Burton J. Wyman, one of the referees in bankruptcy of this court, acting herein as special master, hereby respectfully certify and report:

On February 6, 1941, the above named debtor filed its verified petition for corporate reorganization. In said

PETITION

it is alleged:

“The petition of San Francisco Laundry Association, the above-named debtor, respectfully states: [106*]

“I.

“That debtor is a corporation, duly organized and existing under the laws of the State of California, and has had its principal place of business at the City and County of San Francisco, California, within the above judicial district for more than six months immediately preceding the filing of this petition, to-wit: the debtor has maintained such principal place of business since December 22, 1875. The debtor was incorporated on December 22, 1875.

“II.

“The debtor is a corporation, as defined in the Bankruptcy Act, which could be adjudged a bankrupt under said Act, and is not a municipal, insurance or banking corporation, or a building and loan association, and is not a rail-

*Page numbering appearing at foot of page of original certified Transcript of Record.

road corporation authorized to file a petition under Section 77 of said Act.

“III.

“The debtor is unable to pay its debts as they mature, as will more particularly appear from the schedules hereinafter referred to.

“IV.

“The debtor desires that a plan of reorganization be effected under the provisions of Chapter X of the Bankruptcy Act, and declare that this petition is filed in good faith.

“V.

“The nature of debtor’s business is owning, developing and leasing real property, and leasing and selling laundry equipment. The debtor also formerly operated a general laundry business, which was liquidated prior to the filing of this petition, in the manner set out under paragraph IX(a) hereof.

“VI.

“The schedule hereto annexed, marked Schedule ‘A’, and verified by the oath of the President of your petitioner, contains a full and true statement of all the debts and liabilities [107] of your petitioner. There are issued and outstanding 1000 fully paid shares of the common capital stock of the debtor of the par value of \$100.00 per share.

“VII.

“The schedule hereto annexed, marked Schedule ‘B’, and verified by the oath of the President of your petitioner, contains an accurate inventory of all the assets of your petitioner.

“VIII.

“The schedule hereto annexed, marked Schedule ‘C’, and verified by the oath of the President of your petitioner, contains a statement of the affairs of your petitioner, in form prescribed by the General Orders in Bankruptcy for Debtors Engaged in Business.

“IX.

“The nature of all pending proceedings affecting the property of the debtor so far as is known, and the courts in which they are pending, are as follows:

“(a) On or about May 29, 1936, the debtor assigned to A. L. May, as trustee, all its personal property of every description in trust for the benefit of such of petitioner’s unsecured creditors as desired to become parties to the agreement with said trustee, and most of said unsecured creditors became parties thereto. The debtor has fully complied with all its undertaking under said assignment, and the liquidation of the debtor’s general laundry plant and business was undertaken at the instance of said trustee. Said trustee has completed the admin-

istration of his said trust, and presented to the debtor his first and final report of his trusteeship, but the debtor has made claim against said trustee of errors in said accounting, which claim is pending and unadjusted, and is, therefore, set forth in the schedules annexed hereto at an unknown valuation. No court proceedings have been commenced, or are pending, [108] in connection with such claim.

“(b) Under date of November 14, 1929, the debtor made and executed to American Securities Company, a corporation, as trustee for the benefit of American Trust Company, a corporation, a Deed of Trust, which was recorded on January 7, 1930, in the office of the County Recorder of the City and County of San Francisco, State of California, in Liber 1967 of Official Records, at page 469, to secure the payment to said American Trust Company of the principal sum of \$31,000.00, and that there is now due to said American Trust Company, under said Deed of Trust, the sum of \$33,810.52. Said Deed of Trust covered the real property of the debtor, located on the northerly line of Turk Street, and is more particularly described in Schedule ‘B1’ annexed hereto.

“Said American Trust Company and said American Securities Company have noticed the sale of said real property, pursuant to the terms of said Deed of Trust, for sale at public auction on February 7, 1941, at the hour of

10 A. M. of said day, and unless restrained by this Court, said trustee will sell said real property at said time and place, and said real property will be sold at such sale for a sum not exceeding the above-mentioned balance due under said Deed of Trust, to the irreparable damage and injury of the debtor, its creditors and stockholders. No Court proceeding has been commenced, or is pending, in connection with such sale under said Deed of Trust.

“(c) No plan of reorganization, adjustment or liquidation affecting petitioner’s property is now pending, except as hereinabove set forth.

“X.

“In order for the debtor to obtain relief, it is necessary that the rights of secured creditors of the debtor be modified, in that the principal asset of said corporation is the above mentioned real property located on the northerly line of Turk Street, in said City and County of San Francisco, and [109] which said real property is subject to the above mentioned Deed of Trust to the American Trust Company, and at present a fair market value of said real property is not less than \$45,000.00, and the debtor’s equity in said property at the present market value is in excess of \$11,000.00, and said real property is the principal asset of the debtor. Unless restrained by this Court, said real property will be sold under said Deed of Trust, as

above recited, and unless the rights of said American Trust Company, as a secured creditor and the holder of said Deed of Trust, be deferred and modified, the debtor will lose entirely its equity in said real property, and become wholly bankrupt and compelled to cease its business operations. The debtor's equity in said real property is the only asset out of which it can realize sufficient cash to pay its debts, and if a plan of reorganization under Chapter X of said Act be adopted and the rights of said secured creditor are modified, the debtor will ultimately be enabled to pay its debts in full, and continue its business operations, and your petitioner cannot obtain adequate relief under Chapter XI of the Bankruptcy Act.

“XI.

“It is the desire of your petitioner that a plan of reorganization be effected under the provisions of Chapter X of the Bankruptcy Act.

“XII.

“The schedule hereto annexed, marked Schedule ‘D’, and verified by the oath of the President of your petitioner, contains a copy of the resolution of the Board of Directors of your petitioner, authorizing the filing of a petition for relief under Chapter X of the Bankruptcy Act.

“Wherefore, your petitioner prays:

“1. That an order be entered approving the debtor’s petition as properly filed. [110]

“2. That an order be entered continuing your petitioner in possession and giving it directions for the conduct of your petitioner’s business during the pendency of these proceedings.

“3. That said American Securities Company and said American Trust Company be forthwith restrained from further proceeding with the sale of the real property under the above mentioned Deed of Trust, until further order of the Court.

“4. That your petitioner may have such other and further relief as the Court may deem necessary or proper.

“SAN FRANCISCO LAUNDRY
ASSOCIATION,

“By CHARLES M. BUFFORD
President

(corporate seal)

GAYLORD & GAYLORD

Attorneys for Petitioner.”

(Verification omitted for brevity.)

(See original of said petition on file in the office of the Clerk of this Court.)

In the schedules of said debtor, accompanying said petition, the following debts are listed:

On Schedule A-1, Statement of all creditors to whom priority is secured by the act, is listed taxes

due and owing to the county, district, or municipality of San Francisco, State of California (not delinquent) \$120.00;

Under "Creditors Holding Securities", Schedule A-2, are listed:

American Trust Company, 464 California Street, San Francisco, California, secured by the Deed of Trust dated November 14, 1929 to American Securities Company, as trustee, recorded January 7, 1930, in the office of the County Recorder of the City and County of San Francisco, California, in Liber 1967 of Official Records, Page 469, to secure the payment to said American Trust Company of principal sum of \$31,000.00 and interest rep-

[111]

resented by the promissory note of the debtor of even date with said Deed of Trust. Deed of Trust covers first parcel of real property described in Schedule B-1 attached hereto. Claim is liquidated and current value of security is \$45,000.00. Amount of claim due...\$33,810.52

Florence B. Brownfield, 1278 - 5th Ave., San Francisco, California, representing loan advanced and principal sum of \$3,200.00, secured by Deed of Trust, executed September, 1937, and covering the second described parcel of real property mentioned in Schedule B-2 3,517.17

Claim is liquidated, and current value of security is \$2500.00.

Both of the above obligations represent cash loans made to debtor.

Total.....\$37,327.69''

Schedule A-3, "Creditors Whose Claims are Unsecured", shows a listing as follows:

"Lockwood Trust, 1450 Turk Street, San Francisco, California\$ 25.16
Claim is liquidated and represents moneys deposited with the debtor for convenience of creditor."

There is listed on Schedule B-1, Statement of all Property of Bankrupt, Real Estate":

"All that certain real property situated, lying and being in the City and County of San Francisco, State of California, and more particularly described as follows, to-wit: Commencing at a point on the northerly line of Turk Street, distant thereon 65 feet easterly from the easterly line of Steiner Street; running thence easterly along the said line of

[112]

Turk Street 216 feet 9 inches to a point distant thereon 130 feet 9 inches westerly from the westerly line of Fillmore Street; thence northerly and parallel with the westerly line of Fillmore Street 137 feet 6 inches; thence at a right angle westerly 6 feet 9 inches; thence at a right angle northerly 137 feet 6 inches to the southerly line of Eddy Street; thence at a right angle westerly along the said line of Eddy Street 187 feet 6 inches to a point distant thereon 87 feet 6 inches easterly from the easterly line of Steiner Street; thence southerly and parallel with the easterly line of Steiner Street 187 feet 6 inches to a point distant 87 feet 6 inches northerly from the northerly line of Turk Street, measured at a right angle thereto; thence westerly and parallel with the northerly line of Turk Street 22 feet 6 inches to the intersection of a line drawn at a right angle to the northerly line of Turk Street from the

point of commencement; and thence southerly along the line so drawn, 87 feet 6 inches to the point of commencement. Being portion of Western Addition Block No. 362. Together with the appurtenances.....\$45,000.00
(Subject to Deed of Trust to American Trust Company, \$33,810.52.)

All that certain real property situated, lying and being in the City and County of San Francisco, State of California, and more particularly described as follows, to-wit: Commencing at a point on the easterly line of Steiner Street distant thereon 112 feet 6 inches northerly from the northerly line of

[113]

Turk Street, running thence northerly along the easterly line of Steiner Street 25 feet, thence at right angles easterly 87 feet 6 inches, thence at right angles southerly 25 feet, and thence at right angles westerly 87 feet 6 inches to the point of commencement.....\$ 2,500.00
(Secured by Deed of Trust to Florence B. Brownfield, \$3,517.17.)

Total.....\$47,500.00"

On Schedule B-2, "Personal Property", there are listed:

Cash on hand.....\$199.49
Office furniture and equipment located at 1450 Turk Street, San Francisco, California 289.00

Total.....\$488.49

It also is disclosed by Schedule B-3, "Choses in Action":

"Debts due petitioner on open account,"
Sale contract for laundry equipment for Superior Laundry, 8 Grand Avenue, South San Francisco, California.....\$ 830.00

Sale contract for laundry equipment for Asahi Laundry, San Francisco, California	881.00
---	--------

“Unliquidated claims of every nature, with
their estimated value”,

Unliquidated claim against A. L. May, as
trustee, under assignment of personal prop-
erty for creditors in connection with final
accounting, the value of which is unknown
to the debtor.

“Deposits of money in banking institutions
and elsewhere”,

None, except as listed under “Cash”.

Total.....	\$ 1,711.00
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[114]

The “Summary of Debts and Assets” show:

Schedule A (Liabilities) total.....	\$37,472.85
-------------------------------------	-------------

Schedule B (Assets) total.....	\$49,699.49
--------------------------------	-------------

(See original of said schedule on file in the office
of the Clerk of this Court.)

On February 6, 1941, the following

RESTRAINING ORDER

was signed and filed:

“Upon reading the verified Debtor’s Petition
for Corporate Reorganization heretofore filed
in the above entitled matter, and good cause
appearing therefor,

“It is hereby ordered that American Securi-
ties Company, a corporation, and American
Trust Company, a corporation, and each of
them be and they are hereby restrained and
prohibited until further order of the court
from conducting or proceeding with any sale

under that certain Deed of Trust executed under date of November 14, 1929, by the above-named debtor to said American Securities Company, as trustee for the benefit of said American Trust Company, which said Deed of Trust was recorded on January 7, 1930, in the office of the County Recorder of the City and County of San Francisco, State of California, in Liber 1967 of Official Records at Page 469, which said Deed of Trust covered certain real property situated on the northerly line of Turk Street in said City and County of San Francisco, and which real property is more particularly described in said Deed of Trust.

Dated: February 6, 1941.

HAROLD LOUDERBACK”

(See original of said restraining order on file in the office of the Clerk of this Court.)

February 21, 1941, an order approving petition as properly filed continuing debtor in possession and prescribing powers and duties was filed herein. The order, omitting for the sake of brevity, the [115] preliminary recitals, reads:

“Ordered, Adjudged and Decreed:

“1. That said petition be and it is hereby approved as properly filed under Chapter X of the Bankruptcy Act.

“2. That, subject to the direction and control of the court and until further order herein, the debtor be and it is hereby authorized to con-

tinue in the possession and control of all its assets, properties, lands and estates of whatever kind and description and wheresoever situate, with the title of a trustee appointed under Section 44 of said Bankruptcy Act; and to have the same powers as those exercised by a receiver in equity and trustees in bankruptcy, to the extent consistent with the provisions in Chapter X of the Acts of Congress relating to bankruptcy.

“3. That the debtor be, and it is, hereby authorized and directed, pending further order of this court herein, to conduct, manage, maintain, operate and keep in proper condition and repair, the assets, properties and business of the debtor wherever situated, and to manage, operate and conduct its business, and to employ and discharge and fix the compensation of all officers, attorneys, managers, superintendents, agents and employees, and to collect and receive the income, rents, revenues, issues and profits of its assets, properties and business, and to collect all outstanding notes, and to the extent necessary to protect and preserve the assets, properties and business of debtor, to make and pay for betterments to the properties of the debtor, all according to law, and subject to such supervision and control by the Judge of this court as may be exercised by further orders entered herein.

“4. That not later than April 14th, 1941, unless the time be extended by order of this court, the debtor, if then in possession, shall file with the clerk of this court a plan of reorganization on which a hearing shall be held before [116] this court in accordance with Section 170 of Chapter X of the Bankruptcy Act, in Room of the United States Post Office and Courthouse Building, San Francisco, California, on May 19th, 1941, at 10 o'clock A.M., of said day, for the consideration of any objections or amendments thereto, and to determine whether said plan shall be approved.

“5. That the debtor shall cause notice to be given to the Secretary of the Treasury, the Securities and Exchange Commission and to the creditors and stockholders of the debtor, of a hearing to be held before this court at Room No. of the United States Post Office and Courthouse Building, San Francisco, California, on April 7th, 1941, at 10 o'clock A. M., of said day, to determine whether or not this court shall continue the debtor in possession or appoint a trustee, and to consider the plan of reorganization to be filed by the debtor and any objections and amendments thereto, by mailing on or before Mar. 7th, 1941, a notice of such hearing to the Secretary of the Treasury, the Securities and Exchange Commission and to each creditor and stockholder of the debtor

appearing as such on the books and records of the debtor, addressed to such creditors and stockholders at the address appearing on such records; and by publishing once a week for two successive weeks in 'The Recorder', a newspaper of general circulation printed and published in the City and County of San Francisco, California; said publication to be commenced not later than Mar. 7th, 1941.

"The notice so mailed and published shall be in substantially the following form under the title of the above-entitled court and cause:

'To the Creditors and Stockholders of the above-named Debtor:

'The petition of San Francisco Laundry Association, a California corporation (herein called the debtor) for reorganization and for relief under Chapter X of the Bankruptcy Act, has been approved as properly filed under said Chapter, and an order was filed in these proceedings on, [117] 1941, temporarily continuing the debtor in possession of its properties and authorizing the debtor to operate its business pending further order of the court:

'Notice is hereby given pursuant to the aforesaid order dated Feb. 20th, 1941 of a hearing to be held before the above-entitled court in Room No. of the United States Post Office and Court house Building, San Francisco, California, on Apr. 7th, 1941 at

10 o'clock A. M., of said day, to determine whether or not the court shall continue the debtor in possession or appoint a trustee or trustees, and of a hearing to be held before said court at said place on May 19, 1941, at 10 o'clock A. M., of said last mentioned day, to consider the plan of reorganization to be filed by the debtor or trustee, and any objections or amendments thereto.

'Dated: _____, 1941.

'SAN FRANCISCO LAUNDRY
ASSOCIATION

'By _____,'

"6. That all persons, firms, corporations and associations be, and they are, hereby enjoined until further order of this court from commencing or prosecuting any actions or taking any action whatsoever in any way interfering with the possession, control, operation or management by the debtor of its business and properties.

"7. That the officers of the debtor are authorized to make any or all payments and to draw any or all checks in the ordinary course of business, and to open and maintain a bank account or accounts in such bank or banks as may be selected by the Board of Directors, provided that such bank or banks are authorized depositories of funds under the jurisdiction of this court.

“8. That, pending further order of this court, the debtor is authorized to institute and prosecute in any court or before any tribunal of competent jurisdiction all such suits and proceedings as may be necessary for the recovery or protection of its rights and properties, and to make settlement of any thereof, and likewise to defend any actions, claims, proceedings or suits which may hereafter be asserted or brought in any court, or before any officer, department, commission [118] or tribunal, to which the debtor shall be a party, but no payment shall be made by the debtor in respect to any such claims, actions, proceedings or suits, and no action taken by the debtor in defense or settlement of such claims, actions, proceedings or suits shall have the effect of establishing any claim upon, or right in, properties or funds in possession of the debtor that otherwise would not exist.

“9. That the debtor shall close its books of account as of midnight, February 6th, 1941, and open new books of account immediately thereafter, and cause to be kept therein due and proper accounts of the earnings, expenses, receipts and disbursements of the debtor, and shall preserve proper vouchers for all payments made on account thereof, and deposit the moneys coming into the hands of the debtor in any of the banks in which the funds of the debtor are presently deposited and such other

banks hereafter selected by the Board of Directors of the debtor, provided that such banks are authorized depositories for funds under the jurisdiction of this court.

“10. That not later than Mar. 10th, 1941, unless the time be extended by further order of this court, the debtor shall file with the clerk of this court a schedule of its stockholders of each class, showing the number and kind of shares registered in the name of each stockholder and the last known post office address or place of business of each stockholder.

“1. That the debtor be, and it is, hereby authorized in its discretion from time to time and until further order herein, out of funds now or hereafter coming into its hands, to pay all necessary current expenses of the debtor in preserving its assets and properties, and in conducting its business, including among other expenses the wages, salaries and compensation of officers, attorneys, managers, agents or employees retained by the debtor, and any other services necessary to the continued operation of the debtor's business, [119] and the costs of maintaining the corporate existence of the debtor, and of printing and publishing any necessary pleadings, motions, petitions or orders on file herein, and any and all expenses reasonably necessary to comply with any and all orders heretofore, or hereafter, made by the court herein.

“12. That full right and jurisdiction be, and it is, hereby reserved to make, from time to time, such orders as this court shall deem proper in executing the powers conferred by the provisions of Chapter X of the Bankruptcy Act and, in general, this court reserves full rights and jurisdiction to make, from time to time, such orders amplifying, extending, limiting or otherwise modifying this order and any and all other orders now or hereafter made, as to this court may, from time to time, seem proper.

“Dated: February 20th, 1941.

“HAROLD LOUDERBACK

“Judge of the District Court.”

(See original of said last mentioned order on file in the office of the Clerk of this Court.)

Thereafter, and on April 14, 1941, the following verified

ANSWER

of American Trust Company to petition for corporate reorganization was filed in this proceeding:

“American Trust Company, herein called the Creditor, answering the Debtor’s petition for reorganization and for relief under Chapter X of the Bankruptcy Act, as amended, denies, admits and alleges as follows:

“I.

“Alleges that Creditor is a corporation organized and existing under and by virtue of the laws of the State of California.

“II.

“Alleges that the Debtor is justly and truly indebted to the Creditor on notes and deeds of trust in a sum in excess of \$39,114 for moneys borrowed by the Debtor from the Creditor, [120] for interest accrued thereon, for interest on accrued and unpaid interest, and for moneys advanced by the Creditor pursuant to the terms of said deeds of trust for the payment of taxes subject thereto and interest thereon; that the debtor has not paid any of the taxes on the property subject to said deeds of trust for the fiscal year ending June 30, 1940, nor any part of the taxes on said property for the current fiscal year, and failed to pay \$1,308.77 on account of the taxes for the fiscal years ending June 30, 1933, June 30, 1934, and June 30, 1935; that as a consequence of Debtor's failure to pay said taxes, it was necessary for the Creditor to pay and the Creditor did in fact pay the sum of \$1,308.77 on account of the balance of the taxes on said property for the fiscal years ending June 30, 1933, June 30, 1934, and June 30, 1935, and the further sum of \$1,816.54 for taxes on said property for the fiscal year ending June 30, 1940, and the further sum of

\$819.48 for the first installment of the taxes on said property for the current fiscal year; that no part of the taxes so paid by the Creditor has been repaid to Creditor; that interest has accrued and continues to accrue on the amounts so paid by the Creditor for said taxes and as of March 1, 1941, amounted to \$258.46, no part of which has been paid; that Debtor has not paid any interest on its indebtedness to the Creditor since March 17, 1938; that interest on said indebtedness accrued to March 1, 1941, amounted to \$8,141.76, no part of which has been paid; that interest has accrued and continues to accrue on said delinquent interest and as of March 1, 1941, amounted to \$918.75, no part of which has been paid; that no part of the principal of Debtor's said indebtedness to the Creditor has been paid since prior to August 15, 1936, except the proceeds of the sale of a portion of the property subject to said deeds of trust, amounting to the sum of \$5,900.00 which was paid to the Creditor on September 28, 1939; that the balance of the principal of said indebtedness now due, owing and unpaid [121] is the sum of \$25,810.00, all of which became due long prior to August 15, 1936.

“III.

“Alleges that the fair market value of the property subject to said deeds of trust is far

less than the obligations secured thereby; and that there is no equity in said property for the Debtor, its creditors or stockholders.

“IV.

“Alleges that by the terms of said deeds of trust Creditor is entitled and for more than four years last past has been entitled to the possession of the property subject thereto and to the rents, issues and profits thereof; that Debtor nevertheless has continued in possession of said property and has retained the rents, issues and profits thereof.

“V.

“Alleges that, as more fully appears by Debtor’s said petition and the schedules appended thereto, Debtor has but two creditors in addition to this Creditor, and that the indebtedness due said other creditors amount to \$3,542.33 in the aggregate as contrasted with the sum of \$39,114.78 due this Creditor from the Debtor as of March 1, 1941; that under the provisions of Chapter X of the Bankruptcy Act, as amended, no plan of reorganization can be effected without the consent of this Creditor; that Creditor has the constitutional right to have the property covered by said deeds of trust subjected to the payment of the indebtedness secured thereby; that Creditor is informed and believes and therefore alleges the

fact to be that the petition filed herein was filed for no other purpose than to hinder and delay Creditor in the pursuit of its just rights and remedies.

“VI.

“Alleges that the only businesses which Debtor by the terms of its Articles of Incorporation is authorized to [122] carry on are the business of a laundry and such other businesses as may be connected therewith or necessary for the prosecution thereof; that Debtor has not carried on any business authorized by its Articles of Incorporation for more than two years last past or any business other than the liquidation of its assets; that all of the tangible assets of the Debtor excepting only the real estate subject to deeds of trust held by this Creditor and Florence Brownfield have been sold and the proceeds thereof used and applied to satisfy and discharge the claims of Debtor's unsecured creditors; that Debtor has neither the working capital nor equipment necessary to enable it to carry on business as a going concern; and that it is impossible for the Debtor to be rehabilitated as a going concern.

“VII.

“Answering the allegations of Paragraph III of said petition, admits that the Debtor is unable to pay its debts as they mature, but in that

behalf Creditor is informed and believes that Debtor is insolvent.

“VIII.

“Answering the allegations of Paragraph IV of said petition denies that said petition is or was filed in good faith or for any purpose other than to hinder and delay this Creditor.

“IX.

“Answering the allegations of Paragraph V of said petition, denies that the nature of the Debtor’s business is owning, developing and leasing real property and leasing and selling laundry equipment; and in this behalf Creditor alleges that the only businesses which the Debtor may lawfully carry on under the provisions of its Articles of Incorporation are the business of a laundry and such other businesses as may be connected therewith or necessary for the operation thereof; and that for more than two years last past Debtor has not [123] carried on any business other than the liquidation of its assets.

“X.

“Answering the allegations of Paragraphs VI, VII, VIII and subdivision (a) of Paragraph IX of said petition, Creditor alleges that it has no information or belief sufficient to enable it to answer said allegations and therefore denies each and all thereof.

“XI.

“Answering the allegations of subdivision (b) of Paragraph IX of said petition, admits that the Debtor is indebted to the Creditor and that such indebtedness is secured by deeds of trust on certain real property, but denies that the amount of said indebtedness is \$33,810.52 or any sum less than \$39,114.78; admits that the trustee under said deed of trust proposes to sell the property subject thereto for the purpose of satisfying the obligations thereby secured; alleges that the amount of said obligations is in excess of the value of said property, and that neither the Debtor, its creditors or stockholders will suffer or sustain any injury as a consequence of the sale of said property; admits that no court proceeding has been commenced or is pending in connection with such sale under said deeds of trust; denies all and singular the allegations contained in said subdivision (b) of Paragraph IX of said petition not herein expressly admitted.

“XII.

“Denies the allegations of Paragraphs X and XI of said petition.

“Wherefore, Creditor prays that Debtor be not continued in possession of its assets and estate and that either the proceedings be dismissed or a trustee be appointed, and that Creditor be awarded such other and further re-

lief as may be [124] meet and just in the premises.

“AMERICAN TRUST COMPANY

“By A. C. McINTYRE

BROBECK, PHLEGER & HARRISON

HOWARD J. FINN

Attorneys for American

Trust Company”

[Verification omitted for brevity.]

(See original of said answer on file in the office of the Clerk of this Court.)

Subsequently, and on April 17, 1941, the following

ORDER,

omitting, for the sake of brevity the preliminary recitals, was filed herein:

“It is hereby ordered, adjudged and decreed:

“1. That the issues raised herein by said answer of the debtor be, and the same is hereby, referred to Honorable Burton J. Wyman, an Official Referee in Bankruptcy of this court, as Special Master, to take testimony and report to this court, with all convenient speed, as to such issues, and as to whether a trustee should be appointed herein, and as to whether said petition should be dismissed.

“2. The time within which said debtor may file its proposed plan of reorganization herein is hereby extended to fifteen (15) days from

April 14, 1941, to-wit, to and including April 29, 1941.

“Dated: April 16th, 1941.

“HAROLD LOUDERBACK

“United States District Judge

“Approved as to form as provided in Rule 22.

BROBECK, PHLEGER & HARRISON

Attorneys for the within named
creditor.”

(See original of said last mentioned order on file in the office of the Clerk of this Court.) [125]

At the hearings held before me on April 28, 1941, and May 8, 1941, pursuant to said last mentioned order, Robert B. Gaylord, Jr., Esq., of the firm of Messrs. Gaylord & Gaylord, appeared on behalf of the debtor, and A. M. Dreyer, Esq., representing the firm of Messrs. Brobeck, Phleger & Harrison, appeared on behalf of American Trust Company.

During said hearings, testimony, on behalf of American Trust Company, was given by the following person:

1. GEORGE H. THOMAS, JR.,

who qualified as an expert in the appraisal of properties in and around San Francisco. His valuation of the first parcel of real estate hereinbefore described was \$30,000.00, arrived at, so he stated, by taking into consideration sales of properties in vicinity, the highest and best use to which the prop-

erty might be put, the location, and all elements pertaining to the fair market value of the property.

On

Cross Examination,

this witness further testified:

“Q. Mr. Thomas, you stated you based your value on the laundry property in this case on the highest and best use to which the property can be put. In your opinion, what is that use?

“A. Commercial.

“Q. In what sense?

“A. Well, it could be used for a skating rink, and ice rink, some kind of an amusement center. It really would have to be some kind of special use, I would say, where the people who used it could not afford to put much money into the land and still want a fairly good location. I took into consideration the potentialities, so far as residential is concerned. Due to the fact that the Federal Housing would not lend the money on the property in the vicinity, due to its blighted condition and type of residents, I think the highest and best use would be for some specialized line.

“Q. Have you given consideration, Mr. Thomas, to the value of the property subdivided into lots? A. Yes, I have [126]

“Q. In your opinion would a subdivision of the property increase or decrease its value?

“A. Decrease it.

“Q. How?

“A. Because of the cost that would be entailed in subdividing it, and the amount of available property, and the fact that it would cost as much to build bungalows or flats there as it would in Pacific Heights, and the revenue would be very limited in proportion to what you could get in a better district.”

(For further details with regard to the testimony of the aforesaid witness, see Reporter's Transcript of proceedings of April 28, 1941, and May 8, 1941, pages 3 to 9, inclusive, said transcript being handed up herewith as a part of this certificate and report.)

2. B. A. BANKER,

who also qualified as an expert in appraising properties. He also fixed the market value of the property last referred to at \$30,000.00.

This witness also testified:

“Mr. Dreyer: Q. What price did you place on the property per square foot?

“A. Well, that is about 52 or 53 cents a square foot.

“Q. How does that compare with the selling price per square foot of other subdivisions in San Francisco?

“Mr. Gaylord: Do you want to confine it to that general district?

"The Witness: A. Well, we took into consideration what the property might be sold for if it was subdivided and utilities put in. We subdivided the Oddfellows' Cemetery and the Masonic Cemetery. I think both are located better than this. We sold the Oddfellows' off at about 65 cents a square foot, and the Masonic at about 90 cents, after the utilities were in.

"Mr. Dreyer: Q. What would be the cost of placing utilities in this property if it were subdivided?

"A. We would have to figure that out carefully, but I would imagine if you cut one street through it would be 275 feet, that would be [127] the frontage on each side of the street, and it would cost about \$15,000 to put in the utilities—between 12,000 and 15,000.

"Q. What is the area of that property?

"A. About 56,000 or 57,000 square feet.

"Q. By subdividing it would the value be increased or decreased?

"A. Well, in my opinion you could not subdivide it and get \$30,000 for the property."

* * * * *

"Q. This property is in what is known as the blighted area, is it not?

"A. I have heard it called that."

"Mr. Gaylord: Q. Just a moment. Referring to the blighted area, what is meant by that, in answer to Mr. Dreyer's question?

“A. In the first place, I did not say it was a blighted area.

“Q. I appreciate that.

“A. I think a blighted area is an area in which it is not sound economically to build a new building or make new improvements, on account of the surrounding improvements.”

(See said last mentioned transcript for further details relative to the testimony of said last mentioned witness, pages 9 to 12, inclusive.)

3. EDWARD AHNEFELD,

Assistant Cashier of American Trust Company who gave evidence that, as of April 28, 1941, the “balance of principal of the loan is \$25,810.52; the accrued interest up to date is \$8,391.26; the interest on delinquent interest is \$918.75. There is a balance owing on the redemption of the 1932, 1933, 1934 and 1935 taxes in the amount of \$1,308.77; a partial reconveyance cost of \$5.00; the first installment of 1939-1940 taxes, \$908.27; the second installment was the same, \$908.27; cost of filing default notice and the report, I think the default notices are \$12.00; the first installment of 1940-1941 taxes, \$819.48; the advertising costs, \$23.50; interest on [128] the above tax advances, \$258.46; making a total of \$39,364.28, and that does not include, we have not paid the second installment of the 1940-1941 taxes, which recently went delinquent. * * * I believe they were \$819.48. Yes, they are the same, \$819.48, and penal-

ties will have accrued by now, because it went delinquent last Monday.

“Q. What was the date of the last payment of any nature received from this Debtor?

“A. January 28, 1940.

“Q. The amount? A. \$500.

“Q. What was the amount and the date of the next preceding payment?

“A. March 9, 1939, we received \$1,834.95. I cannot say whether that was one item or a couple of items paid into our accounts payable and taken out in the one amount, but the credit was for \$1,834.95.

“Q. And the date of that?

“A. March 9, 1939.

“Q. So since March 9, 1939, to the present time, nothing has been paid, with the exception of one payment of \$500?

“A. That is right.

“Mr. Dreyer: Will it be stipulated that the indebtedness is secured by the deed of trust on the property shown in the map?

“Mr. Gaylord: That is correct.

“Mr. Dreyer: All the other property originally subjected to that deed of trust has been reconveyed.

“Mr. Gaylord: All except the Brownfield property. That does not show in your map, does it, Mr. Dreyer?

“Mr. Dreyer: Yes, all except this.

"Mr. Gaylord: Sorry, I did not notice this.

"Mr. Dreyer: All except Lot 25.

"Mr. Gaylord: A lot 25 feet wide on Steiner Street.

"Mr. Dreyer: Yes.

"The Referee: The deed of trust does not cover that?

"Mr. Dreyer: No, it does not cover that.

"That is all. [129]

"Cross Examination

"Mr. Gaylord: Q. Mr. Ahnefeld, the sum of \$5,900 was paid to you—I say to you—the American Trust Company, about October, 1939, is that correct?

"A. That was for the release, yes, \$5,900.

"Q. That has been entered in computing your present balance?

"A. It has been, yes.

"Q. You referred to a payment in March of 1939, of \$1,834? A. Yes.

"Q. From January, 1939, to March of 1939, there was approximately \$4,000 paid, was there not? A. No; going back to 1938.

"Q. Speaking of 1939.

"A. \$1,834.95 during 1939.

"Q. Was \$4,000 paid from January to March, 1938, or thereabouts?

"A. Going back to 1938, \$2,339.60.

"Q. When was that payment made?

"A. December 29, 1938.

“Q. That is how much, again?

“A. \$2,339.60.

“Q. And the only payment received in 1940, then, was \$500? A. That is right.

“Q. Between March of 1939 and January of 1940 you received nothing, principal or interest?

“A. That is right. Well, aside from this \$5,900, for which we issued this partial reconveyance.

“Q. \$5,900 shows on your card?

“A. That is right.

“Q. Were those payments applied to principal or interest? A. The \$5,900?

“Q. Yes.

“A. That was for a partial reconveyance; all principal.

“Q. And was the \$1,834.95 principal or interest?

“A. That went on account of tax advances.

“Q. And the \$500 in January of 1940 went on principal [130] or interest?

“A. That went on tax advances.

“Q. That went on tax advances, also. Has there been any extension of the Statute of Limitations on these notes?

“Mr. Dreyer: Not that I know of.

“The Witness: A. No.

“Mr. Gaylord: I think that is all.

“Redirect Examination

“Mr. Dreyer: Just one moment.

“Q. The Debtor has not paid taxes on this property for more than three years, aside from the repayments on account of tax advances made by you?

“A. Our records would indicate no payments. No, they have not been paid.”

(The entire testimony given by the last mentioned witness is found on pages 12 to 17, inclusive, of said transcript.)

4. CHARLES M. BUFFORD,

the president of the debtor, was also called to the witness stand on behalf of American Trust Company, on April 28, 1941. He testified:

“Q. Are you familiar with all the rents which it has been receiving for the property?

“A. Yes.

“Q. What rentals have been received by the association during the past two years?

“The Witness: Have you the statements there? Have you the lists here, Mr. Gaylord?

“A. I cannot go back accurately, Mr. Dreyer, before January 1, 1940, but in the year 1940 the total rentals received were \$1,655, and to that should be added \$487.82 royalty or percentage on the parking concession; and then there is a small portion of that that probably would not run over \$125, that came in on this

Steiner Street property. So the net is about between \$2,000 and \$2,100 on the property subject to the American Trust deed.

“Mr. Dreyer: Q. What disposition is made of that income? [131]

“A. Well, in the first place, there were expenses on the property amounting to \$138.64; and then there was the \$500 payment to the American Trust Company that was mentioned; then the operating expenses of the laundry company, and they ran about \$160 a month gross.

“Q. What did that consist of, \$160 a month?

“A. Salary I drew, \$150, and about \$10.00 a month for miscellaneous expense.

“Q. In other words, you have been drawing an income from the property of \$150 a month?

“A. Yes.

“Q. It has no asset other than this real estate, has it?

“A. Yes, it has the assets mentioned in the schedule here. In proportion to the amount of assets, the amount taken in, the administration was very large, because there has been a great deal of effort made to interest people in the property.

“Q. You are the principal stockholder of the corporation, are you not, Mr. Bufford?

“A. Yes.

“Q. How many shares do you hold?

“A. 696 out of 1,000.

“Q. This corporation was originally incorporated as a laundry company, was it not?

“A. Yes.

“Q. And operated a laundry up until what time? A. Until November 12, 1938.

“Q. And two years prior to that time it made a conveyance for the benefit of creditors, did it not, with the exception of this real estate?

“A. Well, it is pretty hard—I would not describe the conveyance in exactly that form. It was supposed to be for the mutual benefit of the creditors and the company.

“Q. As a result of that conveyance the Trustee operated the business for a period of two years, did he not? A. Yes.

“Q. And then found it necessary to liquidate the business and assets, did he not?

“A. Well, he did it; whether it was necessary or not is another question.

“Q. The fact remains that the business was liquidated by the Trustee?

“A. Yes. [132]

“Q. And all the unsecured creditors, as a result of that conveyance, were paid, were they not?

“A. Everything was paid except the real estate and the mortgages.

“Q. Since 1938 you have not operated as a laundry at all; just had the real estate?

“A. We have had the real estate, and also

had the remaining assets that had to be collected.

“Q. What were the remaining assets?

“A. Some machinery and accounts receivable.

“Q. What was the machinery? They were just two conditional sales contracts, were they not?

“A. Well, at the present time there are two contracts only outstanding, but we have had other things that have been gradually liquidated prior to that.

“Q. For that service you collected \$150 a month, no taxes were paid, for two years nothing was paid on account of the secured indebtedness, was it? A. In two years?

“Q. Yes.

“A. In two years' time the corner was sold at \$5,900, and that was more than the pro-rata that was due on the corner, although it was applied to that corner lot.

“Q. That was a sale of the real estate?

“A. Yes.

“Q. Talking now of payments made from the income of the corporation.

“A. \$500 to the American Trust Company.

“Q. And the balance largely has gone into your own pocket, has it not? You spoke of \$175 for repairs, I think?

“A. Well, the total receipts for 1940 were about \$3,900, and the total operating expenses

for that time were, for my salary, \$1,800, so it was something under 50 percent.

“Q. What was the other income of the corporation, aside from the rents, which you testified amounted to about \$2,100?

“A. On those conditional sales contracts we collected \$479 down payments.

“Q. In other words, for collections?

“A. And some miscellaneous sums, \$143. Excuse me, the miscellaneous sum only [133] came to \$37.00. There was \$143 out of some litigation I had; \$312 in accounts receivable; and \$93.00 in miscellaneous operating; and \$553 from the Trustee.

“Q. Mr. Bufford, you are an attorney, are you not? A. Yes.

“Q. You do not devote your entire time to the management of this business? A. No.

“Q. How much time do you devote to it?

“A. I think, during 1940, about half my time.

“Q. How much during 1941?

“A. About one-half. There has been a great deal of bookkeeping, and one thing and another, this year.

“Q. You have also published a book recently, haven't you? A. Yes.

“Q. Notwithstanding that fact you say you devoted half your time to this business?

“A. Yes; it took half the time for the book

and half for the business. I did the book a great deal out of hours.

“Mr. Dryer: That is all.

“Cross Examination

“Mr. Gaylord: Q. Mr. Bufford, I don’t want to go into this completely at this time, but I would like to clear up one or two points from the figures to which you just testified. You have been drawing, for a period of some years, \$150 as your salary as president, out of the corporate funds; is that correct?

“A. Yes.

“Q. Now, over the period of the past year that aggregated about half the income of the corporation? A. Yes.

“Q. Did you have any other employees working for the corporation, or did you do all the work yourself? A. I did it all.

“Q. Mr. Dreyer referred to a book you had published. What is that?

“A. ‘The Wagner Act,’ published by the Lawyers Cooperative Publishing Company.

[134]

“Q. How long has that book been in the process of organization for publication?

“A. About three years.

“Q. With respect to this assignment, that is, the assignment referred to in your schedules, to A. L. May, for the payment of certain unsecured creditors, you are familiar with that transaction, of course? A. Yes.

“Q. Have your accounts with Mr. May been closed as yet?

“A. No; I have a suit pending against Mr. May.

“Q. In connection with the assignments for creditors? A. Yes.

“Q. For how much have you brought suit?

“A. That suit is for \$49,000.

“Q. And that is in process of litigation at the present time? A. Yes.

“Q. Generally speaking, what is the occasion for the suit? What are the grounds for it?

“A. Well, both mismanagement and failure to properly account for certain items of expenditure. Do you wish me to go into further detail?

“Q. No; the point I want to bring out is that it is a suit arising in connection with the administration of the moneys which were collected and paid over to creditors.

“A. It has taken a great deal of detail work to get up a matter of that kind.

“Q. I just want the nature of it.

“Redirect Examination

“Mr. Dreyer: I would like to ask a few more questions.

“Q. That suit is against the members of the firm of Jacobs, Blanckenburg & May, is it not? A. Yes.

“Q. Mr. Gaylord is the attorney for the Debtor in this proceeding, is he not?

“A. Yes.

“Q. Not the attorney for the corporation in that proceeding? A. No. [135]

“Q. Who are the attorneys?

“A. Robert E. Hatch.

“Q. And yourself?

“A. Well, he joined me just as a matter of courtesy. I did not know he was going to.

“Q. There has been no order of Court authorizing the employment of any attorney other than Mr. Gaylord, has there?

“A. Everything was ready to file before the first of the year, but Mr. Hatch happened to be engaged in some court work and let it lie on his desk.

“Mr. Gaylord: I think the general order covers.

“Mr. Dreyer: I don't think it does, in regard to employing attorneys.

“Mr. Galyord: I will stipulate that the only order made on the suit is the order in connection with the approval of this petition.

“The Witness: The retainer was made either October or November of last year. I expected the matter would be so far ahead that probably it would be out of the way before anything else came on.

“Mr. Dreyer: Q. What arrangements have been made to pay Mr. Hatch?

“A. Mr. Hatch received a retainer of \$250

with 20 percent of the recovery. The \$250 to come out of the 20 percent.

“Q. That arrangement never has been approved by the Court? A. No.

“Q. Purely a contingent arrangement?

“A. Yes, except for the down payment.

“Mr. Dreyer: Well, the only point I have in mind in connection with the suit, Your Honor, I don't like to see the income of the corporation, which really is subject to the deed of trust, being used for the purpose of that litigation. But I will leave that question to be argued later at the conclusion. But I feel strongly that a Trustee should be appointed.

[136]

“Mr. Gaylord: You made reference to the appointment of an appraiser for the property?

“The Master: Yes, I will appoint an appraiser to appraise it.”

(See aforesaid transcript, pages 17 to 23, inclusive.)

On said

CHARLES M. BUFFORD,

called on behalf of the debtor, testified in response to Mr. Gaylord's questions:

“Q. How long have you been familiar with the affairs of the Debtor?

“A. About 40 years.

“Q. Have you been an officer of the corporation for that period?

“A. Since about 1901.

“Q. Do the assets of the Debtor exceed, or are they less than \$250,000?

“A. They are less than \$250,000.

“Q. I believe you testified at the last hearing, and I have forgotten what your testimony was. Will you state what the present rentals of the corporation are?

“A. An average monthly rental for the three months from January 1 to March 31, this year, of \$226.

“Q. \$226 per month. As I understood your previous testimony, the only expenses in connection with the operation of that business are your salary, which is \$150, on which you are drawing \$150, and miscellaneous office expense.

“A. Yes; that and insurance is the only expense, fire insurance.

“Q. Are there any other employees of the company, paid employees?

“A. No, there is no other.

“Q. From what source do these rents come?

“A. There is a three-story flat building on the Turk Street frontage that occupies a frontage of 27½ feet, that brings in \$50 a month, and next to it is a store with a rooming house above, and that building brings in \$75 a month. The tenants in each case pay their own water and other miscellaneous expense, and take the apartments as is. [137]

“Q. You also have a parking lot on the property?

“A. Yes, there is a parking lot on Eddy Street, operated on a basis of 25 percent royalty to the owners.

“Q. About how often are those accounts settled between you and the parking lot?

“A. About twice a week. There is also a small brick building in the center of the lot on the west side that has a frontage on Eddy Street, both. It sets back about 75 feet. The building is about 22 feet wide by 40 feet long, and that is bringing in \$10 a month.

“Q. That is the corporation's building?

“A. Yes.

“Q. Mr. Bufford, referring now to the Debtor's petition in this matter, the corporation, at the time of filing this petition, was unable to pay its debts as they matured, is that correct?

“A. Yes, it was.

“Q. At the time of filing this petition, and for some time prior thereto, what business had the Debtor been engaged in?

“A. Well, it had for some time prior thereto—I will begin back and work forward.

“Q. Take the period of about a year.

“A. About a year, then. In the sale of laundry machinery and equipment; collection of outstanding accounts in connection with that, and of all accounts receivable; the renting of real property; the fitting of this parking lot

and an effort to put the property to a more beneficial use or sell it, the beneficial use being subdivision in the most likelihood.

“Q. You state in your petition, Mr. Buford, that the Debtor formerly operated a general laundry business which was liquidated; that is correct? A. Yes, it is.

“Q. About how long before the filing of this petition was that business liquidated?

A. Well, we sold the business in November, 1938, but it took a considerable length of time after that to realize on the assets, because everything [138] was payable in installments or as the equipment was sold.

“Mr. Gaylord: Mr. Dreyer has agreed to stipulate in connection with the allegations of Paragraph V of the petition and the American Trust Company’s answer, that the following are the authorized businesses for the Debtor corporation, pursuant to its article, referring to Article II of the Articles of Incorporation, the purpose for which the said corporation is formed is to carry on and conduct, in all of its branches, the business of a laundry in the City and County of San Francisco, and such other business as may be connected therewith or necessary for the prosecution thereof, which is the only reference in the articles, I believe, to the nature of the corporation’s business. . . .

“Q. In Paragraph IX of your petition it is stated that there was an assignment made in May of 1936 to one A. L. May as Trustee for certain unsecured creditors. Would you state to the Court generally what the nature of the assignment was?

“A. In the spring of 1936 this assignment was made. It was dated May 29th and went into effect on June 17th. It appeared that at the end of 1935 one of the other laundries in San Francisco had shut down, and the principal creditor there was Patek and Company, a laundry supply house; and being also in business with us, they were instrumental in turning over to us a large section of the business, and we needed additional working capital in order to handle it successfully and satisfactorily; and they agreed that if this trusteeship was made, so they would have additional security, they would see that preferred debts were taken care of and that additional funds were advanced, and it was made with the consent of all creditors involved, secured and unsecured.

“Q. That assignment was ultimately liquidated, that is, the assets covered by it were ultimately liquidated? A. Yes.

“Q. At the time of the filing of this petition there were no court proceedings pending in connection with the [139] liquidation other than the one you have just referred to, is that correct?

“A. There was no court proceeding at all pending at the time this was filed.

“Q. It is also stated in your petition, a deed of trust to the American Trust Company. At the time of filing of this petition, the sale of that property under the deed of trust—the property had been noticed for sale under the deed of trust? A. Yes, it had.

“Q. There were no court proceedings commenced or pending in connection with that deed of trust? A. None at all.

“Q. Other than the default notice?

“A. Yes.

“Q. Except as you have heretofore stated, there was no plan of reorganization, or plan for liquidation or adjustment of the affairs of the corporation at the time of the filing of the petition?

“A. There was one that had been discussed, but it had not come to any definite——

“Q. There was nothing pending?

“A. There was nothing pending, no.

“Q. Mr. Bufford, from your knowledge of the business of the Debtor corporation, you state in your petition that it is necessary for the right of secured creditors to be effected or modified, in order to effect a plan of reorganization. That is correct, is it?

“A. Yes, I stated that.

“Q. Mr. Bufford, in your opinion is it possible for the Debtor corporation to be reor-

ganized in such a manner that it may be continued as a regular business?

“A. I think so.

“Mr. Gaylord: If your Honor pleases, we have been advised, prior to this hearing, that there would be some expert testimony in connection with the valuation of the American Trust Company property, or the property secured by the American Trust deed of trust. That expert testimony has not been forthcoming, as I understand from Mr. Bufford, [140] largely because the better known and qualified appraisers were reluctant to testify in this particular proceeding. We have no expert testimony to present to the Court in connection with the value of that property. As I understand, your Honor will attend, or recently has had——

“The Master: There has been an appraisement made of it. On the appraisal that is subject to the deed of trust to the American Trust Company, it has been appraised for \$30,000; on the other parcel, \$3,250.

“Mr. Gaylord: As I say, we have no further expert testimony to offer in that connection. There are one or two points in connection with considering the expert testimony that has been presented in the appraisement your Honor has had made that I would like to bring out from Mr. Bufford as to his knowledge of the property.

“The Master: He has a right to testify.

“Mr. Gaylord: Q. Mr. Bufford, referring to the square block in San Francisco bounded by Turk, Fillmore, Eddy and Steiner Streets, do you have any knowledge as to sales of property in that area within a recent period?

“The Witness: A. Yes, I have.

“Mr. Gaylord: Q. Will you state to the Court what sales you have knowledge on?

“A. Well, I have the knowledge of the sale at the corner of Turk and Steiner first. That is——

“Q. The northwest corner—the northeast corner?

“A. Block 750, and that has a frontage on Turk Street of 65 feet, and on Steiner of 87 feet 6 inches. That was sold to L. R. Levin in the fall of 1939 for \$6,300. After that Mr. Levin built a gas station on it, and he made a sale to E. G. Kimball about the forepart of 1940. The deed has \$23.00 worth of Internal Revenue stamps on it. He was asking \$18,000, and the rise in price from \$18,000 to \$23,000, as shown by the revenue stamps, is due to a trade-in he made. [141] He took a piece of property in San Mateo County as part consideration in the final deal. That property is on a ten-year lease in favor of the Richfield Oil. The oil station cost approximately \$8,000 to build, not more than that, a little less. Then on the corner of Turk

and Fillmore Streets, with a frontage of 130 feet 9 inches on Turk Street, 85 feet on Fillmore, the property was sold to Gussie Gross on August 2, 1940. The Internal Revenue stamps on her deed show \$68.75, which would indicate a price, as we all know, of \$68,750, although it is said the price was shaded a little, because the testimony here was about \$62,500. Then I have an offer on the parcel—I have two offers on the parcel on Steiner Street, 25-foot frontage and a depth of 87 feet 6 inches, title to which is now in the Debtor corporation. One is a proposition from William F. Raker to buy it for \$2,500, the other is a proposition by the holder of the deed of trust to take it in satisfaction of her trust deed. That property is about 2,200 square feet.

“Q. Do you have any knowledge of any other sales in that block?

“A. There have not been any other sales in that block within the last five years that I know of.

“Q. How long have you been familiar with the property, Mr. Bufford?

“A. I have been buying and selling it, as president of the company, for 20 years, and prior to that I was a director of the company, when we made some other real estate transactions in the same block.

“Q. Referring now, Mr. Bufford, particularly to the property covered by the American

Trust Company deed of trust, what, in your opinion, is the value of that property?

“A. I think that property is worth a dollar a square foot. I base that on the value of the surrounding property. This offer that I have for the Steiner Street property is at the rate of \$1.10 per square foot. Fillmore Street frontage [142] was sold, including the building which is very old, at something like \$6.00 a square foot—almost \$6.00. It has something less than 11,000 square feet in it. And the oil station was sold originally, the site of the oil station was sold by me in the fall of 1939, at \$1.10 a square foot, and it has since sold, from Levin to Kimball, for considerably more than that. The diagonal property in the block from Steiner to Pierce and Turk to Golden Gate changed hands about three years ago at about the same figure, a little over a dollar a square foot. The real estate in that particular neighborhood shaves off in value from Fillmore Street.

“Q. From Fillmore to Steiner?

“A. Yes, from Fillmore to Steiner. When the Stafford appraisal was put on property in that block by Stafford and his advisory committee 15 years ago, that was indicated very strongly. Mr. Stafford’s committee put a value of about 50 percent more on the land in the block adjoining Fillmore than he did on the land in the block between Steiner and Pierce. For instance——

“Q. That is a value 15 years ago.

“A. A value 15 years ago, and he made \$220 to \$150 a front foot on the Turk Street front, and on the Eddy Street front the values are higher, it ran from \$260 to \$175 a front foot. \$175 in the block from Steiner to Pierce, and above that in the block down to Fillmore.

“Q. You have had under consideration, have you not, for some period of time, and have been working on a proposed plan for the re-organization of the Debtor?

“A. Yes, I have.

“Q. Will you outline generally for the Court the present setup of that plan?

“Mr. Gaylord: There has been no plan filed, your Honor.

“The Witness: A. This lot, your Honor, is about an average width of 200 feet, and runs through a distance of 275 feet from Turk to Eddy, and the proposal which we are [143] working out is to put a street 50 feet wide between house lines through from Eddy to Turk, and put so-called duplexes, two flats over a garage, on 25-foot lots on either side of that, which would divide the property up into lots 70 feet in depth, each lot with a 25-foot frontage and with an extra lot on Turk Street adjoining, where there is additional width of the property. The lots would comply with the requirements of the Federal Housing Authority for housing loans, and with all requirements of

the Street Board and other City authorities at the City Hall. The buildings would have a depth of about 50 feet, with back yards in between 15 and 20 feet depth. The buildings would cost between \$6,500 and \$7,000 per unit, and would sell at a figure, considering the rentals that are available, that would net \$2,000 per lot income to the Debtor corporation, there being 23 lots, and four of them corner lots, which would bring in a gross in excess of \$46,000.

“We have an architect, George E. Ralph, who has drawn preliminary plans for the buildings; a contractor by the name of Theodore Petrikis, who is willing to go ahead; a street contractor by the name of Ted Hardy has figured the street work; and a broker by the name of C. F. Ross, a licensed realty broker, who has some contacts through which he believes he will be able to place the houses on the market as completed and sold; and we believe that through this plan of putting these improvements on, it will be possible to retire the loan of the American Trust Company, and also realize an equity for the Debtor corporation. The plan has been figured quite thoroughly and I believe all figures involved are within the legitimate costs, the legitimate costs appropriate to that neighborhood.

“The street once laid out will form a little community of its own. At either end of the street, across the street on one side, will be the

wall of the car barn of the Market Street Railway, which forms a quiet ending for the street, so there is no undesirable tenant or vista at that end; and at [144] the other end the rear of the New Fillmore Theater lies, which will form a quiet street and vista as one looks north along this new street.

“Mr. Gaylord: Q. Do you have estimates or figures of the expense of constructing such a street as you have outlined? A. Yes.

“Q. And also the utility work?

“A. The estimates that have come from the various contractors that Mr. Ralph has called in on the work run between \$3,000 and \$4,000. We propose a street with a paved section 26 feet wide, which is the right width for a small street like that according to the Street Department of the Board of Public Works. It permits automobiles to be parked on either side and an automobile to drive down the middle. The sidewalks sit back in line with the house, with plenty of turning room for automobiles. The sewer work is only a small branch sewer to connect with the main branch on Turk Street, and there is no grading to be done, because the lot at present is on the grade of the present street, which keeps the street work at a minimum.

“Mr. Gaylord: That is all.

“Cross Examination

“Mr. Dreyer: Q. Mr. Bufford, the plan of reorganization, the assignment which was made

under date of May 29, 1936, was executed by the San Francisco Laundry Association and A. L. May, was it not? A. Yes.

“Q. I ask you if this is a copy of the agreement of assignment?

“A. Yes, that is a copy.

“Mr. Dreyer: May I introduce this in evidence?

“The Master: American Trust Company’s Exhibit No. 1 of this date.

“Mr. Dreyer: Q. That assignment, Mr. Bufford, recites [145] that the company is unable to pay its debts. Is that recital true or not?

“The Witness: A. Yes, that was true, it had not got the ready cash to pay the debts, true in that sense; not true in the sense that it did not have assets and property sufficient to pay.

“Mr. Dreyer: Q. But at least ever since the Trustee under that assignment shut down the business the only business in which the Debtor corporation has been engaged has been the liquidation of its assets?

“A. And the management of its real estate.

“Q. Mr. Bufford, how much rental has the corporation received since this petition was filed?

“A. What date was it filed, Mr. Dreyer?

“Q. I believe it was filed in February.

“A. February 6th.

“Mr. Gaylord: Yes, February 6th. It is notaried the 5th and I presume it was filed the 6th.

“The Master: February 6th.

“The Witness: Between \$400 and \$450.

“Mr. Dreyer: Q. Where is that money?

“A. What has not been spent is on deposit in the American Trust Branch at Fillmore and O’Farrell.

“Q. How much is there?

“A. About \$200 on deposit.

“Q. Have you paid your salary out of that right along? A. Yes.

“Q. There has been no order of Court authorizing you to pay salary?

“A. Yes, the order so provides.

“Q. Coming back to this so-called plan of reorganization which you outlined, Mr. Buford, that plan is nothing more than a plan for liquidation of the real estate. The corporation, after all of its lots are sold, will go out of business?

“A. That is a matter of the future that is hard to say. It is conceivable that the company might liquidate its debts and still continue to hold the future of the building. [146]

“Q. But in any case the corporation does not intend to engage in the business for which it was originally incorporated?

“A. No, unless one assumes—unless one so interprets the provision connected with the

laundry, the company being engaged in real estate at the time that the articles were filed back in 1875, and it always has been at all times ever since.

“Q. You know, Mr. Bufford, that the Federal Housing Authority will not extend any loans in that neighborhood?

“A. They said they would.

“Q. Who told you that?

“A. The Federal Housing Authority.

“Q. Who?

“A. They told Mr. Ralph, the architect.

“Q. You mentioned some property—excuse me—well, there is nothing to add. You mentioned some property in this vicinity that sold at \$1.10 a square foot, did you not?

“A. Yes.

“Q. Which property?

“A. That is property the Piombo Bros.—they first sold the property to the Associated Oil Company at the diagonal corner.

“Q. Is that on the part of the property originally subject to the American Trust Company deed of trust?

“A. We are speaking across the section, across the street. You are speaking of the L. R. Levin piece.

“Q. That is right.

“A. That was originally subject to the deed of trust, yes.

“Q. But that is a corner lot, is it not?

“A. Yes.

“Q. And this other appraisal you speak of is diagonally across the street, and is also a corner lot?

“A. It is a corner lot, an inside property, just like the laundry property.

“Q. What do you mean by that?

“A. There is an oil station on the corner, but the sale to Piombo Bros. included a section, a large section of land farther up the block. [147]

“Q. There are no corner lots on this property? A. No.

“Q. It is all inside property?

“A. Yes. The advantage of the subdivision I propose is that it will create four corner lots.”

(See pages 24 to 36, inclusive, of the transcript heretofore referred.)

The questions as to whether or not the debtor should be continued in possession of its assets and estate, or whether or not the proceedings should be dismissed or a trustee appointed, were submitted on briefs at the conclusion of the hearing held on May 8, 1941, and those briefs have been filed.

In the meantime, and on May 31, 1941, said debtor filed with the court the following

PROPOSED PLAN OF REORGANIZATION:

“Whereas, the above named debtor has duly filed herein its petition for reorganization under the provisions of Chapter X of the Bankruptcy Act, and such reorganization under said plan will tend to rehabilitate the financial status of the debtor, and a reorganization under the provisions of said Chapter X will be to the best interests of the creditors and stockholders of the debtor;

“Now, Therefore, the debtor hereby proposes the following plan for the purpose of effecting a reorganization of its corporate affairs:

“An audit of the books of the debtor herein, made as of February 6, 1941, discloses the following: (Adjustment of American Trust Company debt made to March 1, 1941.)

“SUMMARY OF ASSETS

“Cash on hand.....	\$ 90.43
Open accounts receivable.....	985.00
Accounts receivable on contract.....	1,612.00
Furniture and fixtures.....	289.00
Real Estate	47,500.00
Unliquidated claim against A. L. May, as trustee (Action filed for \$46,000.00, liquidated value of claim uncertain.)	

Total.....\$50,476.43

[148]

“SUMMARY OF LIABILITIES

“Preferred creditors	\$ 120.00
Secured creditors:	
American Trust Company.....	39,364.28
Florence B. Brownfield.....	3,517.17

Total.....\$43,001.45

“I.

“Amendment of Articles

“The debtor proposes to amend its articles of incorporation, and in so far as necessary, its By-Laws, in order that the debtor shall have the necessary corporate powers and authorized stock to carry out this plan of reorganization, in the following three respects, to-wit:

“(a) The corporate powers of the debtor shall be amended by adding thereto the following powers, to-wit:

“(1) In every manner and form to acquire, convey, encumber, own, improve, hold, deal in, operate, develop, manage and control real property of every character.

“(2) In every manner and form to acquire, convey, encumber, own, hold, deal in, operate, manage and control personal property of every character.

“(3) To enter into partnership and joint enterprises of every character in whatsoever line of business engaged whether a business similar to that authorized by these articles of incorporation or otherwise.

“(4) In every manner and form to conduct the business of buying, selling, manufacturing, dealing in and installing manufactured products of any and every character.

“(5) In every manner and form to conduct the business of manufacturing and/or contracting and/or building business for con-

struction and/or installation work of every character. [149]

“(6) In every manner and form to borrow and lend money to secure the payments of obligations of any and every character.

“(7) To enter into contracts and obligations of every character and to incur indebtedness in any and every manner and form.

“(8) To do all acts and things necessary or convenient for and incidental to and in any way connected with all or any of the foregoing enumerated purposes.

“(9) To do any and all acts and things which any natural person lawfully may do or perform.

“(b) To authorize the issuance of \$20,000.00 par value preferred stock of the debtor, such stock to be divided into 200 shares of the par value of \$100.00 per share, and to have an absolute liquidation preference over all other stock of the debtor, and each share to have one vote in the affairs of the corporation, and to share prorata in dividends, if any, on a per share basis with the outstanding common stock of the debtor. Such stock shall be redeemable by and at the will of the debtor, in whole or in part, at any time, or from time to time, at par for cash, and shall be redeemed in the manner hereinafter provided.

“(c) To change the name of the debtor to ‘Cozy Lane Corporation’.

“II.

“Expense Fund

“The debtor proposes to create an expense fund to be applied to the payment of expenses, taxes and other charges provided for in this plan, which fund shall consist of the present cash on hand and to be collected, rents to be collected, receipts from general accounts receivable, and receipts from contract accounts.

[150]

“III.

“Sinking Fund

“The debtor proposes to create a sinking fund, to consist of the gross proceeds of the sale of its real estate, as provided in this plan, said fund to be applied in the manner hereinafter provided.

“IV.

“Certificates of Indebtedness

“The debtor proposes to issue non interest bearing certificates of indebtedness, to have absolute priority over all corporate obligations, secured and unsecured, such certificates to be issued in amount and used for the payment of the necessary expense of building the duplex apartments and performing the necessary street, subdivision and utility work in effecting the real estate subdivision hereinafter mentioned.

“V.

“Subdivision of Real Estate

“The principal asset of the debtor is the following described real estate, situated in the City and County of San Francisco, California, and more particularly described as follows, to-wit:

“Commencing at a point on the northerly line of Turk Street, distant thereon 65 feet easterly from the easterly line of Steiner Street; running thence easterly along the said line of Turk Street 216 feet 9 inches to a point distant thereon 130 feet 9 inches westerly from the westerly line of Fillmore Street; thence northerly and parallel with the westerly line of Fillmore Street 137 feet 6 inches; thence at a right angle westerly 6 feet 9 inches; thence at a right angle northerly 137 feet 6 inches to the southerly line of Eddy Street; thence at a right angle westerly along the said line of Eddy Street 187 feet 6 inches to a point distant thereon 87 feet 6 inches easterly from the easterly line of Steiner Street; thence southerly and parallel with the easterly line of Steiner Street 187 feet 6 inches to a point distant 87 feet 6 inches northerly from the northerly line of Turk Street; measured at a right angle there-to; thence westerly and parallel with the northerly line of Turk Street 22 feet 6 inches to the intersection of a line drawn at a right

angle to the northerly line of Turk Street from the point of commencement; and thence southerly along the line so drawn, 87 feet 6 inches to the point of commencement. Being portion of Western Addition Block No. 362.

[151]

“The parcel of land here in question is the largest at present available for a housing development in the entire Fillmore district; and is peculiarly well situated for subdivision purposes. It is immediately adjacent to the Fillmore shopping district, which includes many modern stores, and is close to the most desirable residential construction in the district. As the duplex dwellings herein proposed will face their own quiet street, the project will create its own favorable atmosphere, dominate the housing trend in the immediate neighborhood, cater to those who prefer to live closer in town where distances are less and climatic conditions better, and bring a desirable class of residents and buyers.

“The debtor proposes that said real estate shall be subdivided into twenty-three lots of twenty-five feet frontage, and a public street, fifty feet in width, including sidewalks and parking way, shall be dedicated across said real estate, all in conformity with the subdivision plat of said property attached hereto, marked Exhibit ‘A’, and hereby made a part hereof. The debtor’s property to be subdivided is cov-

ered by the proposed street and Lots Numbers 7 to 38 inclusive, as shown on said plat.

“Whereas, George E. Ralph, as architect, T. D. Harney, as street contractor, and Theodore Patrikis, as general contractor, represented by Herman H. Friedman, are ready, willing and able to proceed forthwith, upon the confirmation of this plan, with the construction of the duplex dwellings in accordance with this plan;

“The debtor, therefore, proposes, upon confirmation of this plan, to construct on Lots 20, 21, 22, 35, 36 and 37, as shown on said plat, duplex dwelling houses, to consist generally of a garage, and the usual facilities on the ground floor, and two dwelling floors above, all in conformity with the laws and ordinances applicable thereto, and the standards of the Federal Housing Administration, and proposes to proceed upon confirmation of this plan, with the construction of said street and [152] the installation of the necessary utilities for servicing such duplex dwellings.

“The debtor is advised and believes that said duplex dwellings can each be constructed for approximately \$6500.00, and the debtor proposes that said duplex houses be constructed at the minimum reasonable cost, and in view of the present increasing construction costs, the debtor proposes that the cost of said duplex houses be limited to \$7500.00 each, and further proposes that the cost of said street work and

the installation of said utilities be limited to \$4000.00.

“The debtor proposes, upon confirmation of this plan, to enter into a contract with said Herman H. Friedman, and said contractors and architect, for the construction of said street, utilities and duplexes, in accordance herewith, which contract shall be subject to the approval of said court, and that the plans and specifications for said houses shall be subject to the approval of said court.

“The debtor proposes that the cost of said dwellings, street work and utilities be borne by the issuance to said Herman H. Friedman, as the representative of said contractors and architect, of said certificates of indebtedness, in an amount equal to the actual cost of such work, such certificates to be issued as work progresses, and against architect’s certificates in the customary manner.

“Upon completion of each unit of said duplexes, the same shall be sold by the debtor for cash, at the fair market value, but in no event at less than an amount equal to the costs of sale, and the cost of the construction of such duplexes, plus $\frac{1}{23}$ of the cost of such street and utility work, plus $\frac{1}{23}$ of the principal of note hereinafter provided for the American Trust Company. The balance of such purchase price above \$1500.00 shall, upon each sale, be paid one-half to Herman H. Friedman for said con-

tractors and architect, as their share of the profit of the joint enterprise of developing said [153] subdivision, and the remaining one-half thereof shall be applied in the following order:

“1st, to the payment of current taxes of the debtor.

“2nd, to the payment of the expense of conducting the business of the debtor.

“3rd, to the payment of current interest on said note, to said American Trust Company.

“4th, to the redemption of the remaining lots in said plat from said note to said American Trust Company.

“5th, to the redemption of said preferred stock.

“After each of said duplexes shall have been sold, the debtor proposes to construct, finance and sell an additional duplex upon another of said lots upon the same terms and conditions and subject to the same restrictions and application of proceeds as the above mentioned duplexes, until all of said lots shall have been so improved and sold.

“VI.

“Preferred Creditors

“There is only one preferred creditor of this debtor, namely, the City and County of San Francisco, California, for property taxes, and the debtor proposes to pay delinquent taxes in full from said expense fund, upon confirmation of this plan.

“VII.

“Secured Creditors

“There are only two secured creditors of the debtor, namely, Florence B. Brownfield, and the American Trust Company.

“(a) Florence B. Brownfield. The amount due this secured creditor is \$3,517.17, plus interest accruing and to accrue. Said obligation is secured by a Deed of Trust on the property of debtor, situated in the City and County of San Francisco, California, and particularly described as follows, to-wit:

“Commencing at a point on the easterly line of Steiner Street distant thereon 112 feet 6 inches northerly from the northerly line of [154] Turk Street, running thence northerly along the easterly line of Steiner Street 25 feet, thence at right angles easterly 87 feet 6 inches, thence at right angles southerly 25 feet, and thence at right angles westerly 87 feet 6 inches to the point of commencement.

“The value of said last mentioned real estate in no event exceeds the amount of said debt, and said last mentioned creditor, prior to the filing of this petition, indicated a desire upon her part to accept a conveyance of said real property by the debtor in full satisfaction of her debt, principal, interest and advances, and the debtor proposes that in full satisfaction of said debt, it shall, upon confirmation of this plan,

convey said real property to said Florence B. Brownfield, in satisfaction of her debt.

“(b) American Trust Company. The debtor is indebted to the American Trust Company in the principal sum of \$25,810.52, together with cash advances made by said bank in the sum of \$3,985.29, together with interest to March 1, 1941, not in excess of the sum of \$9,318.97, and interest accruing and to accrue upon said obligation at six per cent per annum. Said obligation is secured by a Deed or Deeds of Trust upon all of the lots shown on said plat.

“The debtor proposes, upon confirmation of this plan, and in satisfaction of said obligation of the American Trust Company, to issue to said company its promissory note in the principal sum of \$29,795.81, being the principal of said obligation, together with cash advances, with interest thereon at the rate of four and one-half per cent per annum from the date of said note, said note to be payable on or before two years from the date thereof, and interest to be payable semi-annually commencing six months from the date of said note. The debtor further proposes that said note shall be secured by a Deed of Trust upon all of said real estate shown on said plat, excepting the portion thereof which the debtor proposes to dedicate for a public street. [155]

“The debtor further proposes, upon confirmation of this plan, to issue to the American

Trust Company, its said preferred capital stock of the par value equal to the interest upon said present obligation to the American Trust Company to the date of issuance of said stock.

“The debtor further proposes that upon payment to the American Trust Company, from the proceeds of the sale of each of said duplexes, of 1/23 of the principal of said note, that said Deed of Trust shall be released for the purposes of sale upon that portion of the property on which such duplex so sold is constructed.

“VIII.

“Unsecured Creditors

“That there are no unsecured creditors of the debtor.

“IX.

“Future Conduct of the Business

“The debtor, after approval and confirmation of this plan of reorganization, proposes to conduct its corporate affairs along the same lines, and to maintain the same policy as heretofore, but does not intend to engage in the general laundry business, or in the purchase and sale of laundry equipment, until this plan has been fully effected, other than the collection of present outstanding laundry accounts and the collection of moneys from outstanding accounts on laundry equipment heretofore sold.

“X.

“Litigation

“The debtor has commenced suit against one A. L. May for \$46,000.00, and the debtor proposes to prosecute said suit to final judgment. The debtor prior to the filing of its petition for reorganization herein, agreed to pay to Robert E. Hatch, for services as its attorney therein, the sum of \$250.00, as a retainer, plus a contingent fee of fifty [156] per cent of the first \$1,000.00 of the net recovery therein, and twenty-five per cent of the balance, and the debtor proposes, subject to the approval of said court, to complete said contract and to apply the net proceeds of said suit in the same manner and order as the proceeds of the sale of said duplexes.

“XI.

“Officers’ Salaries

“The only officer of the debtor who receives any salary is its President, who now receives the sum of \$150.00 per month. It is proposed that such salary be continued and that the President, until this plan is fully effected, shall be the only paid employee or officer of the debtor.

“Cost of Administration

“The cost and expense of administration of this proceeding are to be borne by the debtor solely, and to be paid in cash on the date of the confirmation of this plan, from said ex-

pense fund. As to allowance to attorneys for debtor for services rendered herein, as well as for services which may be rendered, the debtor and his counsel have agreed to leave the same to the sole discretion of said court.

“Conclusion

“It is respectfully submitted that the foregoing plan is fair and equitable in all respects, and the debtor respectfully requests all creditors to join in a consent to this plan, so that they, as well as the debtor, will receive the maximum benefits.

“Respectfully submitted,

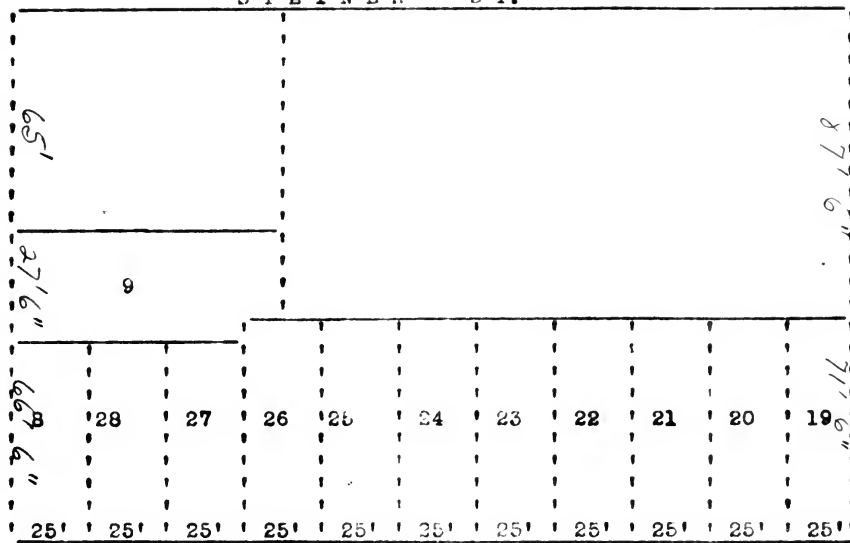
“SAN FRANCISCO LAUNDRY
ASSOCIATION

[Seal]

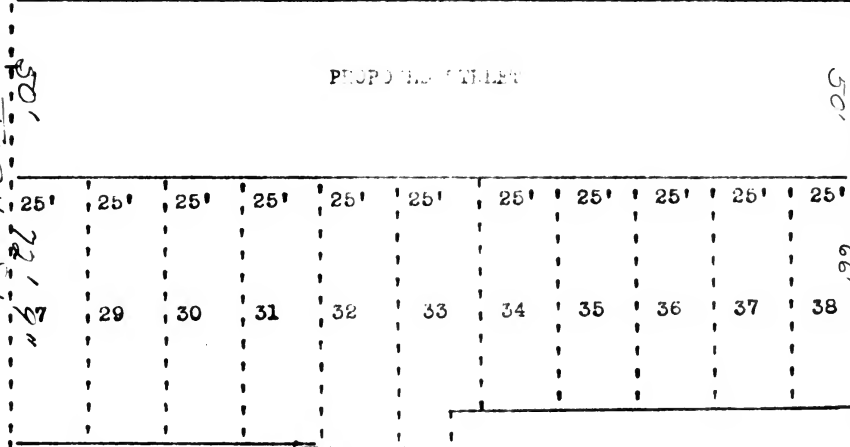
“By CHARLES M. BUFFORD
“President

Debtor.” [157]

STEINER ST.



PROPOSED LOTTERY



PILLMORE ST.



(See original thereof in the office of the Clerk of this Court.)

On June 18, 1941, the following

OBJECTIONS OF AMERICAN TRUST COMPANY TO PROPOSED PLAN OF REORGANIZATION

were filed herein:

“American Trust Company, a creditor of the Debtor above named, hereby objects to the plan of reorganization proposed herein by the Debtor, on the ground that the said plan is unfair and inequitable in each of the following particulars:

“1. Said Debtor is insolvent and the said plan of reorganization contemplates the realization by the Debtor and the stockholders and officers of money, assets, and property of the Debtor at the expense of the Creditor.

“2. The said plan of reorganization contemplates the creation of a prior encumbrance upon the property hypothecated to the Creditor, notwithstanding the fact that the obligations due from the Debtor to the Creditor far exceed the value of said property.

“3. The said plan of reorganization discriminates unjustly in favor of Florence B. Brownfield, a creditor of the Debtor, and against the Creditor, in that it contemplates that the property hypothecated to said Florence B. Brown-

field shall be conveyed to her in satisfaction of the obligations owing to her but contemplates that the property hypothecated to the Creditor shall be retained by the Debtor.

“4. The said plan of reorganization provides for the scaling down of the indebtedness owing to the Creditor.

“5. The said plan of reorganization contemplates that the assets of the Debtor shall be used in a speculative venture for which there is no reasonable prospect of success.

“Wherefore, said American Trust Company prays that said plan of reorganization be disapproved and that the proceedings [159] be dismissed or the Debtor adjudicated a bankrupt.

“BROBECK, PHLEGER
& HARRISON

“Attorneys for American
Trust Company, Debtor.”

(See original thereof in the office of the Clerk of the Court.)

The following

ORDER OF REFERENCE,

omitting therefrom the preliminary recitals, was made herein on June 18, 1941:

“It Is Hereby Ordered, Adjudged and Decreed: That the issues raised herein by the objections of the American Trust Company to the Debtor’s proposed plan of reorganization be

and the same are hereby referred to Honorable Burton J. *Wymen*, as special master to take testimony, and report to this Court with all convenient speed as to such issues and as to whether the said plan should be approved or the proceedings dismissed, or the Debtor adjudicated a bankrupt.

Dated: June 18, 1941.

“A. F. ST. SURE

“United States District
Judge.”

(See original thereof in the office of the Clerk of this Court.)

A hearing was held before the undersigned on said objections on June 19, 1941, at which time I was attended upon by Robert B. Gaylord, Jr., Esq., representing the firm of Brobeck, Phleger & Harrison, the attorneys for American Trust Company, the objecting creditor.

The following

PROCEEDINGS

were had at said last referred to hearing: [160]

“The Master: You may proceed with the San Francisco Laundry Association.

“Mr. Dreyer: This matter comes again before your Honor on the hearing of the Debtor’s proposed plan of reorganization and the objections thereto interposed by the American Trust Company.

“The Master: I have copies before me. I have the file, the District Court file, and also I have the orders of reference.

“Mr. Dreyer: Well, what is the ordinary order of procedure? Perhaps Mr. Gaylord would like to outline the provisions of the plan.

“The Master: Very well.

“Mr. Gaylord: I don’t know whether the Court has had an opportunity to review the plan.

“The Master: I looked it over when it first came in; I have not looked at it since.

“Mr. Gaylord: I will run through the major highlights. The plan, in general, sets forth a summary of the assets and liabilities of the Debtor, which showed at the time the figures were gotten up, general assets of just over \$50,000, consisting in part of cash, a small amount of cash, quick assets totalling approximately \$3,000. There is one preferred creditor, the City and County of San Francisco, for taxes, and there are two secured creditors; one being the American Trust Company, and the other being a Florence Brownfield, who holds security on one lot adjoining the general property here in question.

“The plan provides for an amendment of the Articles of Incorporation in certain respects in order to enable the Debtor to have proper power to carry out this proceeding. It is not necessary to go into them in detail. It further

provides for the creation of an expense fund, which consists of the quick assets of the corporation, cash, accounts [161] receivable, and some contracts receivable, and proposes that the expenses of this proceeding be paid from that fund; it also proposes the creation of a sinking fund consisting of pieces of San Francisco real estate as is later provided in the plan, and for the issuance of certificates of indebtedness which shall have absolute priority over secured and unsecured creditors to the extent of what, in effect, is new money coming into the business. The plan provides for the erection of certain structures on subdivided property, and it is proposed to pay for those improvements with the certificates of indebtedness.

“Your Honor will recall from the previous hearing the general property involved, and it is proposed to subdivide that property by running a 50-foot street approximately through the middle, from Turk to Eddy Street, and subdividing the remaining property into some 23 lots of an average of about 25 feet and a depth varying from 66 feet to something over 77 feet. There would be, in the subdivision plan, some 23 lots.

“The Debtor proposes, in the first instance, to erect upon six of those lots, given by number—I believe they are the lots facing on Eddy Street—duplex dwelling houses, the general outline of which is given in the plan, and has an

understanding with one Mr. Ralph, an architect, and Mr. Hardy, a street contractor, and Mr. Petrikis, general contractor, all represented by Mr. Friedman, who are ready to proceed with building these duplex houses and receive payment in certificates of indebtedness which bear no interest. The Debtor proposes immediately to build six of those dwelling houses; as soon as one is sold, to continue developing, lot by lot, and the Debtor has estimated, in connection with the various contractors and the architect, that those duplexes can be constructed at the present time for approximately [162] \$6,500. I appreciate that building costs and so forth are going up, and no one knows how high they will go. For that reason the maximum limit of \$7,500 has been placed on the various dwellings, and the maximum of \$4,000 for the installation of streets and necessary utilities, which the Debtor is advised by the contractors can be installed for not in excess of that figure.

“As I say, the Debtor proposes, on the completion of the units, to sell one unit and build another, on the same basis, and proposes that the dwellings and lots on which they are situated shall be sold for not less than the price which equals the proportionate cost of the street work, the proportionate cost of the note to the American Trust Company, and the balance of the purchase price over \$1,500, which would leave a small margin to the Debtor there, to be

applied first to the payment of taxes, the expense of conducting the business, the payment of interest on the note of the American Trust Company, and the redemption in so far as there is equity over that redemption, of additional lots from the American Trust Company's mortgage.

"With respect to the preferred creditors, in the case of Mrs. Brownfield, the only other secured creditor, the Debtor proposes to transfer her property to her in satisfaction of her debt, believing the value will warrant such a transfer. So far as the American Trust Company is concerned, the Debtor proposes to execute a new note for something in excess of \$25,000, being the balance of principal on their debt, plus their cash advances, also including the interest. I believe there is a proposed reduction of the rate of interest on the new note, $4\frac{1}{2}$ percent. The principal of the note now would be \$29,000, and it is proposed to issue for the interest now accrued at six percent on the American Trust Company note, preferred stock to the American Trust Company, [163] which will have a liquidation preference over other stockholders of the corporation.

"There are no unsecured creditors in this matter. I might make an explanation. There was a showing in the original schedule of unsecured obligations, I believe, of \$23.00, something like that, which, as it developed, was not,

in effect, a claim against the Laundry Association; it was a trust, and it seems this trust used the same bank account as the San Francisco Laundry. In reality, it was their money. There are no unsecured creditors.

“In respect of the future conduct of the business, the Debtor proposes to continue along the same line as now, and further proposes, in connection with a suit that has been filed in a rather substantial sum, the exact value of which no one can tell at this time, to apply what proceeds there may be from that suit to the payment of the obligations in the order above outlined.

“The only salaries to be paid are a proposed salary for the president, Mr. Bufford, of \$150 a month. The plan further provides there shall be no other salaried employees of the Debtor.

“With respect to the other costs of administration and so forth to be approved by the District Court:

“As Mr. Dreyer said, I am not sure what your Honor’s procedure on these matters is.

“The Master: This is a motion to dismiss.

“Mr. Dreyer: This is an opposition.

“The Master: It really amounts to a motion.

“Mr. Dreyer: To dismiss or adjudicate the Debtor a bankrupt.

“The Master: Yes.

“Mr. Dreyer: I would like to introduce in evidence, your Honor, the testimony which was

adduced on the hearing on the issues raised by the answer, if agreeable. [164]

Mr. Gaylord:

“I have no objections, Mr. Dreyer. The only thing in connection with the expert testimony, I have no objection to stipulating that if they were called they would testify the same as before, but I do object to the admission of their testimony in so far as the present value of the real estate is concerned in its existing condition. I believe the proper basis of valuation of the property for the purpose of the plan of reorganization would be the value of the property as improved and subdivided with duplex structures erected upon it. In other words, whether this plan is practical or not depends almost entirely upon whether or not the duplex houses and the lots on which they are situated can be sold to realize equity over the obligations against them. As I understand, I don't think the testimony as to the existing values of the land is material.

“Mr. Dreyer: If the Court please, I think that is the only evidence that is material. We cannot be compelled to enter into a speculative venture which is entirely dependent on whether or not they can sell these houses for the prices they indicate. I think, so far as the Debtor is concerned, the present value of the assets is far less than the amount of obligations. Neither the stockholders nor anybody else ex-

cept the American Trust Company has any right to vote on this plan. So I think the present value is the only question involved.

“The Master: I think so, Mr. Gaylord; otherwise you are speculating on what maybe will happen in the future.

“Mr. Gaylord: Of course, that is necessarily true of any reorganization, is it not, your Honor, whether the business can be operated at a profit or not? Which comes back to the same thing: whether its product, whatever it may be, can be sold at a profit.

“The Master: That is true, but so far as fixed assets are concerned, you have to take them at the present value. [165]

“Mr. Gaylord: I would like to submit authorities on that point. But I have no objection to stipulating, as Mr. Dreyer suggests, except for the objection just made.

“The Master: As I recall it, there is expert testimony both ways on the matter as to whether or not they could be subdivided.

“Mr. Dreyer: That is correct.

“Mr. Gaylord: If my recollection is correct, I believe Mr. Banker—I have forgotten the name of the other man who testified—testified he had not considered the property as subdivision property.

“The Master: He said because he knew something about the cost of subdividing, and it could not be done.

“Mr. Gaylord: He also placed the cost of the utilities at \$15,000 against \$4,000.

“The Master: I understand, but that is a difference of opinion there as to who is right.

“Mr. Gaylord: I would like to submit authorities.

“The Master: Very well.

“Mr. Gaylord: I do feel the value is a prospective value.

“The Master: Do you want to submit it?

“Mr. Dreyer: I think we may as well submit it.

“The Master: Now, about your authorities, say five, five and three?

“Mr. Dreyer: That is agreeable.

“The Master: Very well.

“Mr. Dreyer: There is one point I would like to take up with your Honor before we adjourn; that is, some question is raised in the brief filed by the Debtor to the effect that some value should be given to the claim against Mr. May. Now, if that is seriously urged, I guess I should go into the question of the value of that claim.

“The Master: You can do that in your brief. [166]

“Mr. Dreyer: It would require some kind of examination as to the merits of the suit.

“The Master: How can you determine what a Court is going to decide?

“Mr. Dreyer: I don’t know, but the Debtor asserts it should be given value. This is a litigated case; certainly Mr. May is not conceding that he is obligated to them in the amount of \$46,000; actually he is contending he is not obligated in any amount whatsoever. The contention raised in the brief previously filed here is that giving consideration to that claim, the Debtor is not insolvent. If that is the case, certainly I want to try the issue here.

“Mr. Gaylord: Mr. Dreyer, I have carefully avoided putting in any of the financial statements a showing of any actual value on that claim other than to mention it, because I appreciate that nobody can say what it is worth. On the other hand, it is an asset of the Debtor; for that reason it has been mentioned as the proceeding went along.

“Mr. Dreyer: I think, your Honor, to give some basis to show there is no valid claim against Mr. May, I will introduce a copy of the complaint filed against him. The complaint is obviously fatally defective, particularly considered in the light of the assignment I have previously introduced in evidence.

“Mr. Gaylord: Of course, that amounts to a trial of a lawsuit here, your Honor.

“The Master: Well, if you are resting on the claim, I presume counsel would have the right to try the matter here.

“Mr. Gaylord: I have no objection to the complaint going in for the purpose of showing the nature and so forth of the claim made.

“Mr. Dreyer: I want to go further than that. I think that is already gone into. It does not state a cause of [167] action. I don’t know, it might be possible to amend the complaint, but taken in the light of the assignment previously introduced, I don’t see how they have any cause of action whatsoever.

“The Master: If the Debtor claims that is a valuable asset, isn’t it up to him to prove it?

“Mr. Dreyer: I imagine that is right.

“The Master: In the absence of any testimony showing it is a valuable asset, why, the Court would have to say it is a speculative matter, because what a Court is going to decide is pretty hard to determine.

“Mr. Gaylord: I agree with that. On the other hand, I am not prepared to try the suit here.

“Mr. Dreyer: In view of the fact that you are not agreeing to try it here, are you claiming it has any value?

“Mr. Gaylord: I simply made reference to that claim in the brief, showing the existing claim outstanding. I appreciate that nobody can tell what its value is without a trial of the suit. If this Court tried it here, the Superior Court might well take another view.

“The Master: Surely. But isn’t it up to the Debtor, who claims it is a valuable asset, to make some showing here other than the mere mention of it?

“Mr. Gaylord: If it is to be considered that it has a specific value in the statement of assets and liabilities, yes.

“The Master: Do I understand you are waiving that claim?

“Mr. Gaylord: We are not waiving it.

“The Master: You are just leaving it in its present state?

“Mr. Gaylord: We are just leaving it in its present state. If Mr. Dreyer cares to put in the complaint, there is no objection to that. [168]

“Mr. Dreyer: I think I better put it in so there will be some basis, if there is no objection on your Honor’s part .

“The Master: There is no objection, but I don’t see that anything is before me; just something referred to in the briefs. If you want to put it in, it is all right, Mr. Dreyer.

“Mr. Dreyer: I am quite in accord with your views on it, your Honor. I think I will leave it out.

“The Master: Then the matter is submitted?

“Mr. Gaylord: If your Honor please, may I put Mr. Bufford on the stand for a few questions in connection with the subdivision?

“The Master: Surely; yes.

“CHARLES M. BUFFORD

“Recalled.

“The Master: You have been sworn already.

“Mr. Gaylord: Q. Mr. Bufford, you state in the plan of reorganization originally executed by you as president, that the street work in connection with this subdivision shall not exceed the sum of \$4,000. Upon what do you base the statement that the street work can be put in for that amount?

“The Witness: A. Well, I discussed the matter last year with Mr. Fay, of the Fay Improvement Company.

“Mr. Dreyer: I object to that. You cannot testify as to that conversation, Mr. Bufford.

“The Witness: Well, you asked what I based it on. On my investigation as to the cost of the street work.

“Mr. Gaylord: Q. What investigation have you made?

“A. I investigated from the Board of Public Works, or the Street department of the engineer's office in the City Hall, what was necessary, and was informed that a 26-foot pavement was satisfactory with the city authorities. Then [169] I ascertained the cost of the various elements that went into a street of that width.

“Mr. Gaylord: I believe Mr. Bufford already testified he was familiar with property values and so forth.

(Testimony of Charles M. Bufford.)

“The Master: Yes.

“Mr. Gaylord: It is not necessary to go into that.

“Q. Mr. Bufford, in your opinion what can these lots be sold for improved with duplex dwellings as outlined in your plan?

“Mr. Dreyer: Just a minute, your Honor. I assume that testimony will be based on the fact that he is an officer of the company that is the owner of the property.

“Mr. Gaylord: Also, as a matter of fact, I believe Mr. Bufford testified that he dealt in real estate out there some number of years.

“Q. How many years?

“The Witness: A. Forty years. I studied real estate values in that neighborhood quite thoroughly.

“Mr. Dreyer: I think I have the right to go into the question of his qualifications.

“The Master: Yes.

“Mr. Dreyer: Q. Have you ever bought or sold real estate?

“The Witness: A. Yes.

“Mr. Dreyer: Q. At what prices, where located, and at what times?

“A. Both bought and sold right in that particular block.

“Q. Name the parcels, the dates, the amounts and prices.

(Testimony of Charles M. Bufford.)

“A. I sold a parcel on Fillmore Street in 1918, with a frontage of 22 feet on Fillmore Street, at a price of about \$600 a front foot.

“Q. Where on Fillmore Street was that located?

“A. It is between Turk and Eddy. And 85 feet north of Turk Street. [170]

“Q. Who was the owner of that property?

“A. The San Francisco Laundry Association, the Debtor. I sold it to the California Baking Company.

“Q. What other sales have you made?

“A. I sold the corner of Turk and Fillmore with an 85-foot frontage on Fillmore Street and 130 feet and some inches on Turk Street, in 1923.

“Q. Whom did you sell it to?

“A. I cannot tell you the gentleman's name offhand. He is a gentleman who has an office there at about 130 Sutter Street, in the back of the building, the rear of the same building where Grace Perego's real estate office is.

“Q. Who was the owner of that property?

“A. The same, the Debtor.

“Q. I take it that all the sales you made have been sales of property owned by the San Francisco Laundry Association?

“A. Yes. Then I bought property also in that block. I bought this lot on Steiner Street,

(Testimony of Charles M. Bufford.)

which is the subject of the deed of trust held by Mrs. Brownfield, at public auction.

“Mr. Dreyer: I submit, your Honor, he cannot qualify as an expert. He can testify to the value as an owner.

“The Master: I think that is true.

“Mr. Gaylord: Q. Have you personal knowledge of other sales in the district, Mr. Bufford?

“The Witness: A. Yes; a sale in the block above there last year, to the Piombo Bros., the draying company.

“Mr. Dreyer: Q. I think you testified.

“A. I think I testified about that thing.

“Q. And your information was obtained from the records, was it not?

“A. Well, yes.

“Q. The revenue stamps and deeds?

“A. And also from other sources. [171]

“Mr. Dreyer: I think, your Honor, it is quite competent for him to testify as an owner, and his evidence can be considered; I don't think it is entitled to the weight of expert testimony.

“The Witness: It is also the custom of real estate people in the real estate business to figure city real estate on a depth of 100 feet for all estimates of front foot value, and real estate people, ever since the middle of the last century, have been developing tables for depth values on real estate. For instance, the first table of

(Testimony of Charles M. Bufford.)

that sort that was developed was back about 1850, in New York, where it was figured that the front 25 feet of a lot of that depth had 40 percent of the value; the next 25 feet had 30 percent; the next 25 feet 20 percent; and the rear 25 feet 10 percent. In other words, they call it a four, three, two, one rule. That rule was afterwards——

“Mr. Dreyer: May I ask the materiality of this, Mr. Gaylord?

“Mr. Gaylord: Q. I was going to say, Mr. Bufford, will you testify as an officer of the Debtor corporation, and the testimony previously adduced, as to your knowledge of the value in the district?

“Mr. Gaylord: But the objection, I take it, goes to the weight of Mr. Bufford’s testimony.

“Q. Answer the previous question I asked as to what, in your opinion, these lots will sell for improved in the manner outlined in the proposed plan of reorganization.

“The Witness: A. The reason I was making the statement I did was because a shallow lot is worth more per front foot in a city than a deep lot. It has a greater value per square foot, owing to the fact that it has more frontage.

“Mr. Gaylord: Q. Mr. Bufford, would you be kind enough just to answer the question previously asked? [172]

(Testimony of Charles M. Bufford.)

"The Witness: Give me the question again.

"Mr. Gaylord: Q. As to what, in your opinion, these lots, improved as outlined in the plan, can be sold for.

"A. They will have a value of about \$2,000 a lot.

"Q. Talking about improved, what is the sale price? A. The Land value.

"Q. I am not asking the land value; I am asking what the lots, improved as outlined in the plan, will sell for.

"A. About \$10,000 a lot.

"Q. Mr. Bufford, is the land in this district improved with other residence property?

"A. Yes.

"Q. To what extent? I am asking what you personally know about it, what sort of houses, apartment houses, dwelling houses, where are they, and so forth.

"A. There are, across the street on Eddy Street, from where this proposed development is, there is a row of flats; nextdoor to it, to the west on Eddy Street, there are two flats; in the back, to the east of it from Fillmore to Webster, between Eddy and Turk, there are a number of apartment houses of various sizes, and there are other residences both on Eddy and Turk Street. In the back, to the west of it, one side of the block is occupied by Foster &

(Testimony of Charles M. Bufford.)

Kleiser; the other side is occupied partially by residences.

“Q. Are there any new improvements going into this district, so far as you know?

“A. Across the street is a modernization program going on for these flats I spoke of, on the north side of Eddy between Fillmore and Steiner, and in the last six months the flat immediately to the west of the property has been modernized.

“Q. Do you have any knowledge as to the demand for residence property in the district?

“A. Yes.

“Q. What is the demand?

“A. Very good. There are no vacancies in the neighborhood, or very few vacancies, I should say. The vacancies, as I checked, are less than 10 percent. [173]

“Mr. Gaylord: I think that is all.

“The Master: Cross examination?

“Mr. Dreyer: No questions.

“The Master: The matter may be submitted.

“(Submitted—5, 5 and 3)”

(See original of Reporter's Transcript of proceedings of June 19, 1941, handed up herewith as a part of this certificate and report.)

Although there have been hearings on two different matters in connection with this debtor proceed-

ing, as is shown in detail by the record herein, I am of the opinion that the court can best deal with the pending questions on the basis of American Trust Company's prayer at the end of its objections "that said plan of reorganization be disapproved and that the proceedings be dismissed or Debtor adjudicated a bankrupt."

Proceeding on the theory just stated, I find from the record that each and all of said objections are true, and I therefore conclude, as matters of law, that said objections are sufficient upon which to base an order disapproving the proposed plan of reorganization and dismissing the debtor's proceeding, or an order adjudicating said debtor a bankrupt.

I therefore respectfully recommend that the court make one or the other of the aforesaid prayed for orders.

Special Master's Fees and Expenses

I am of the opinion that the sum of \$100.00 is a fair and reasonable sum to be paid me as my compensation as special master for holding the three hearings hereinbefore referred to, and the preparation of this certificate and report.

I also am of the opinion that the sum of \$19.75 is a fair and reasonable sum to be allowed Mrs. Carolyn R. Blair to cover the per diem of the stenographic reporter at the hearing of June 19, 1941, and the preparation of the aforesaid transcript of her notes taken [174] at said last mentioned hearing.

I also am of the opinion that the sum of \$5.00 is a fair and reasonable sum to be allowed B. J. Abrott for his services in appraising the real property of the above named debtor.

I also am of the opinion that the sum of \$30.00 is a fair and reasonable sum to be allowed me for my office and clerical expenses in connection with said hearings and the preparation of the within certificate and report.

I respectfully suggest that in any order which is made in connection with this certificate and report, provision be made for the aforesaid allowances, or such other allowances as to the court shall seem proper in the premises, and that any allowances which are made by the court in this connection be made payable by the objecting creditor, said allowances to be chargeable as costs against the estate of said debtor whether the proceedings herein be dismissed or that said debtor be adjudicated a bankrupt.

Papers Handed Up Herewith

I hand up herewith the following papers:

1. Appointment, Oath and Report of Appraiser;
2. Reporter's Transcript of hearings held on April 28, 1941 and May 8, 1941;
3. Brief of American Trust Company;
4. Brief of San Francisco Laundry Association on Answer of American Trust Company;
5. Reporter's Transcript of Hearing held June 19, 1941; and

6. Debtor's Brief on Objections of American Trust Company to Proposed Plan of Reorganization, and

7. Envelope containing evidence.

Dated: July 24, 1941.

Respectfulliy submitted,
BURTON J. WYMAN,
Special Master.

[Endorsed]: Filed Jul. 24, 1941. [175]

[Title of District Court and Cause.]

DEBTOR'S EXCEPTIONS TO CERTIFICATE
AND REPORT OF SPECIAL MASTER ON
ISSUES RAISED BY ANSWER OF AMER-
ICAN TRUST COMPANY TO PETITION
FOR CORPORATE REORGANIZATION
AND OBJECTIONS OF AMERICAN
TRUST COMPANY TO PROPOSED PLAN
OF REORGANIZATION.

San Francisco Laundry Association, the above named debtor, hereby notes the following exceptions to said certificate and each of its recommendations, findings and rulings, dated and filed herein on July 24, 1941:

1. That said certificate is erroneous in finding that [176] said debtor is insolvent.

2. That said certificate is erroneous in finding that the plan of reorganization herein contemplates

the realization by the debtor and stockholders and officers of money, assets and property of the debtor at the expense of the creditors.

3. That said certificate is erroneous in finding that said plan of reorganization contemplates the creation of a prior encumbrance upon the property hypothecated to the creditors.

4. That said certificate is erroneous in finding that the obligations due from the debtor to the creditor exceed the value of the debtor's property.

5. That said certificate is erroneous in finding that the said plan of reorganization discriminates unjustly in favor of Florence B. Brownfield, a creditor of the debtor, and against the creditor.

6. That said certificate is erroneous in finding that said plan of reorganization provides for the scaling down of the indebtedness owing to the creditor.

7. That said certificate is erroneous in finding that said plan of reorganization contemplates that the assets of the debtor shall be used in a speculative venture.

8. That said certificate is erroneous in finding that said plan of reorganization presents no reasonable prospect of success.

9. That said certificate is erroneous in that said special master at the hearing in connection therewith considered only the present value of the security for the obligation of said American Trust Company.

10. That said certificate is erroneous in that the special master at the hearing in connection therewith refused to consider the subdivided and improved value of the security of the [177] of the obligation of said American Trust Company.

11. That said certificate is erroneous in that no findings of fact are made therein.

12. That said certificate is erroneous in that no findings of fact or conclusions of law or either of them are made with respect to the answer of said American Trust Company.

GAYLORD & GAYLORD,

Attorneys for Debtor.

Received, copy of the within Debtor's Exceptions this 2 day of August, 1941.

BROBECK, PHLEGER &
HARRISON,

Attorneys for American Trust
Company.

Received, copy of the within Debtor's Exceptions this 2nd day of August, 1941.

BURTON J. WYMAN,
Special Master.

[Endorsed]: Filed Aug. 2, 1941. [178]

District Court of the United States
Northern District of California
Southern Division

At a Stated Term of the Southern Division of the United States District Court for the Northern District of California, held at the Court Room thereof, in the City and County of San Francisco, on Friday, the 12th day of September, in the year of our Lord one thousand nine hundred and forty-one.

Present: The Honorable Harold Louderback, District Judge.

No. 33553-L.

In the Matter of
SAN FRANCISCO LAUNDRY ASSOCIATION,
Debtor.

(ORDER DISAPPROVING REORGANIZATION PLAN, DISMISSING PROCEEDINGS, AND ALLOWING CERTAIN FEES, etc.)

The Special Master's certificate and report filed July 24, 1941 on the issues raised by the answer of the American Trust Co. to the Petition for Corporate Reorganization, having been submitted and fully considered, It Is Ordered that the said Special Master's Certificate be and the same is hereby affirmed and the exceptions thereto are hereby overruled. It Is Further Ordered that the Plan of

Reorganization be and the same is hereby disapproved and these proceedings are hereby Dismissed. Further ordered that the following fees be and the same are hereby allowed, payable to the objecting creditor and chargeable as costs against the estate of the Debtor, viz:

1. Special Master's compensation.....	\$100.00
2. Special Master's stenographic reporter.....	19.75
3. Special Master's clerical expenses, etc.....	30.00
4. To B. J. Abrott for his services in appraising the real property of the debtor.....	5.00

[179]

[Title of District Court and Cause.]

NOTICE OF MOTION

To the Clerk of this Court, and to
Brobeck, Phleger & Harrison, and
Mr. Howard J. Finn, Attorneys for
American Trust Company:

Please take notice that on Monday, the 13th day of October 1941, at the hour of 10 o'clock A. M., or as soon thereafter as counsel may be heard, in the courtroom of Hon. Harold Louderback, Judge of said court, in the United States Postoffice & Court House Building, San Francisco, Calif., the above debtor will move the court to amend its decree issued in this matter, Sept. 12, 1941, disapproving the plan of reorganization heretofore filed herein, and dismissing the proceedings, so as to grant the debtor leave, within such time as the

court shall prescribe, to amend said plan or to present an alternative plan calculated to meet and remove objections. [180]

Said motion will be based on the affidavit and the points and authorities hereto attached, on all the files and records in the case, and on such evidence as may be adduced at the hearing.

GAYLORD & GAYLORD,
Attorneys for debtor.

October 9, 1941.

Received a copy of the above and within notice of motion, affidavit and points and authorities, October 9, 1941.

BROBECK, PHLEGER &
HARRISON,
Attorneys for American Trust
Company.

[Endorsed]: Filed Oct. 9, 1941. [181]

[Title of District Court and Cause.]

AFFIDAVIT

State of California,
City and County of San Francisco—ss.

Charles M. Bufford being sworn says: that he is president of debtor corporation;

That it was his and the debtor's understanding and belief, until they had notice of the court's decree herein, dated Sept. 12, 1941, that in the event

objections of American Trust Company to the plan of reorganization heretofore proposed by it in this proceeding were sustained, time would be afforded the debtor to amend said plan or present an alternative plan calculated to meet and remove objections, and that such leave would be granted as part of the court's order; that for that reason and no other the debtor did not make request, specifically, for such leave in the event of such disapproval; [182]

That this court, on April 14, 1941, upon the filing of American Trust Company's answer to the petition on file herein, referred all issues thereby tendered to Burton J. Wyman as Special Master, and on June 18, 1941, upon the filing of American Trust Company's objections to the debtor's proposed plan of reorganization, issued its order providing "that the issues raised herein by the objections * * * be and the same are hereby referred to Honorable Burton J. Wyman, as special master to take testimony, and report to this court * * * as to such issues and as to whether the said plan should be approved or the proceedings dismissed or the debtor adjudicated a bankrupt;"

That it was the understanding and belief of the debtor and his counsel that, upon the issuance of said Special Master's certificate and report recommending that the debtor's proposed plan of reorganization be disapproved, the debtor's proper procedure was to file exceptions to the certificate and report with this court, and await the ruling of this court thereon before taking any further

steps, either by way of amendment of said plan or of proposal of a different plan; that the scope of the references to said Special Master went no further than to provide for the hearings eventuating in the certificate and report; that his jurisdiction and authority were wholly exhausted when the same was issued; that he was not authorized to entertain amendments or different plans; and that it was not appropriate or proper that the same or either of them be presented to him in the absence of a further reference to him by this court;

That affiant verily believes that a plan of reorganization can be presented that will further the purposes and meet the requirements of the law and receive the approval of this court, and in that regard affirms that, if granted leave by this court, the debtor will propose a plan containing the following provisions: Extension of maturity of the mortgage trust deeds held by the debtor's two creditors until one year after the President shall [183] proclaim the end of the present National Emergency, subject to an earlier sale of the property subject to either trust deed, or any part thereof, by mutual consent of the parties thereto; in the meantime one-half of the gross income of the property subject to each trust deed to go to the holders thereof, such holders to pay the taxes, the other half to go to the debtor, the debtor to be responsible for maintenance and upkeep; interest to be reduced and penalties set aside; the court to reserve jurisdiction

of the case for the purpose of authorizing improvements on any of the property in the event the same become desirable and issuing certificates of indebtedness in payment, if hereafter found proper in the sound discretion of the court;

That unless the debtor is granted leave to amend the plan of reorganization heretofore proposed, or to propose a different plan, it will suffer great and irreparable injury, and the result will be shockingly unjust to the debtor's stockholders;

That the decree dated Sept. 12, 1941, was taken against the debtor through its inadvertence and excusable neglect and mistake.

CHARLES M. BUFFORD

Subscribed and sworn to before me this 9th day of October 1941.

(Seal)

R. A. ANDERSON,
Notary Public in and for the City and County of
San Francisco, State of California.

My commission expires May 19, 1943.

[Endorsed]: Filed Oct. 9, 1941. [184]

District Court of the United States
Northern District of California
Southern Division

At a Stated Term of the Southern Division of the United States District Court for the Northern District of California, held at the Court Room thereof,

in the City and County of San Francisco, on Wednesday the 22nd day of October, in the year of our Lord one thousand nine hundred and forty-one.

Present: The Honorable Harold Louderback, District Judge.

No. 33553-L.

In the Matter of

SAN FRANCISCO LAUNDRY ASSOCIATION,
Debtor.

(ORDER DENYING MOTION TO AMEND
ORDER ENTERED SEPTEMBER 12, 1941
etc.)

The motion to amend order entered September 12, 1941 having been submitted and fully considered, the Court finds that upon the facts as presented to the Court and upon the Report of the Special Master (heretofore approved), no plan could be proposed which would be acceptable under the provisions of the Bankruptcy Act, and, therefore, It Is Ordered that the said motion to amend order of September 12, 1941 be and the same is hereby denied. [185]

[Title of District Court and Cause.]

NOTICE OF APPEAL FROM DECREE AND
ORDER

To the above-named court, and to all parties in
interest in the above-entitled matter:

Notice is hereby given that San Francisco Laundry Association, a corporation, debtor in possession appointed as such in said matter, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit, from the following:

From the decree issued in said matter September 12, 1941, affirming the Special Master's certificate therein; overruling the exceptions thereto; disapproving the plan of corporate reorganization presented in said matter; dismissing said proceeding; and allowing fees as in said decree set forth; and from the whole thereof; [186]

From the order issued in said matter October 22, 1941, denying the motion of said debtor, noticed October 9, 1941, and heard October 13, 1941, praying the court to amend its said decree, so as to grant the debtor leave, within such time as the court should prescribe, to amend said plan of reorganization or to present an alternative plan calculated to meet and remove objections.

The amount involved in said decree and in said order, each respectively, is in excess of \$500.00.

GAYLORD & GAYLORD

Attorneys for said debtor

October 22, 1941

[Endorsed]: Filed Oct. 22, 1941. [187]

[Title of District Court and Cause.]

AFFIDAVIT AS TO AMOUNT INVOLVED IN
APPEAL

State of California,

City and County of San Francisco.—ss.

Charles M. Bufford being sworn says that he is president of debtor corporation;

That by order of this court duly made said debtor was continued in possession of its estate involved in this above-entitled matter; that the least value placed on said estate by any witness before the Special Master appointed by the court in this matter exceeded \$30,000.00; that said Special Master did not find the value of said estate, but found it insolvent; [188]

That in the event the decree of this court issued in this matter September 12, 1941, affirming said Special Master's certificate, disapproving the plan of corporate reorganization heretofore proposed in this matter, and dismissing this matter, becomes final, the debtor will realize nothing from said estate; that in the event said plan of reorganization, or a different, fair, equitable and feasible plan, is approved and confirmed, said debtor may reasonably be expected to realize from said estate in excess of \$10,000.00; that the amount involved in the appeal of said debtor from said decree, and the value of the property affected by said decree, are each in excess of \$500.00.

CHARLES M. BUFFORD

Subscribed and sworn to before me this 22nd day of October 1941.

M. E. VAN BUREN

Deputy Clerk, District Court
The U. S. Nor. Dist. of California

[Endorsed]: Filed Oct. 22, 1941. [189]

[Title of District Court and Cause.]

CONCISE STATEMENT OF POINTS ON
WHICH APPELLANT INTENDS TO RELY

The following is a concise statement of the points on which the appellant intends to rely on the appeal.

1

The Special Master's failure to find on the issues raised by the answer of American Trust Company to the petition may be explained and justified only on the ground that said answer was not filed within the time prescribed by the Act, and for that reason was a nullity: in that view of the case, the allegations of the petition must be deemed admitted for all the purposes of the case: in the event said answer is deemed sufficient to tender issues, the Special Master's Report and Certificate is fatally defective in that it wholly failed to find thereon.

[194]

2

The plan of corporate reorganization proposed by appellant May 31, 1941, is clearly fair and equitable

within the meaning of the Act, and of all judicial standards that have been worked out; and to refuse to approve it is an abuse of discretion.

3

Said plan is clearly feasible within the meaning of the Act, and of all judicial standards that have been worked out; and to refuse to approve it is an abuse of discretion.

4

The finding of the Special Master, approved by the district court, that each and all of the objections of American Trust Company to said plan, are true, is prejudicially erroneous, and appellant has excepted to it, in each of the following respects:

a. Insofar as the same relates to that portion of Objection 1, alleging that the debtor is insolvent, said finding is contrary to the weight of evidence, and to said company's admissions resultant from its failure to answer within the time prescribed by law.

b. Insofar as the same relates to that portion of Objection 1, alleging that said plan contemplates the realization of something by the debtor at American Trust Company's expense, said finding is not supported by evidence, and is contrary to the express provisions of said plan.

c. Insofar as the same relates to that portion of Objection 2, alleging that the obligations

due from the debtor to American Trust Company far exceed the value of the property hypothecated to said company, said finding is contrary to the weight of evidence, and to said company's admissions resultant from its failure to answer within the time prescribed by law.

d. Insofar as the same relates to Objection 3, alleging that said plan discriminates unjustly in favor of the holder of the mortgage trust deed on the debtor's smaller parcel of land, said finding is not supported by evidence, and is contrary to the express provisions of said plan.

e. Insofar as the same relates to Objection 4, alleging that said plan provides for the scaling down of the indebtedness owing American Trust Company, said finding is not supported by evidence, and is contrary to the express provisions of said plan.

f. Insofar as the same relates to Objection 5, alleging that said plan contemplates a speculative venture for which there is no reasonable prospect of success, said finding is not supported by evidence, is directly contrary to the only evidence in the record touching said matter, and is contrary to the express provisions of said plan. [195]

5

Certain of the objections to said plan, raised by American Trust Company, and deemed important, if not controlling, by the Special Master and the district court, are without force or validity:

a. The issue raised by Objection 1, whether or not the debtor is insolvent in the absolute sense, is wholly immaterial for the purposes of this case.

b. The point made in Objection 2, that said plan contemplates the creation of a prior encumbrance upon the property hypothecated to said company, is wholly immaterial, for the reason that the Act expressly authorizes certificates of indebtedness with absolute priority for labor and materials enhancing the value of the security.

c. The point made in Objection 3, that said plan discriminates unjustly in favor of the holder of the mortgage trust deed on the debtor's smaller parcel of land, if valid, goes only to a minor detail of the plan; and in the event it were sustained, could and should be remedied by amendment to said plan, and is not sufficient ground for rejection of said plan.

6

The appellant excepts to the ruling of the Special Master as prejudicial, that the only question of land value before him was the then present value of the parcel of land subject to American Trust Company's mortgage trust deed in its then present condition, and his refusal to consider its value were said plan carried out.

7

The refusal of the district court to grant appellant leave to amend its said plan, or to present a

different plan after disapproval of said first plan, was prejudicial error, no opportunity for amendment of said first plan, nor for substitution of a different plan, having been granted at any stage of the case.

CHAS. M. BUFFORD

Attorney for debtor

October 31, 1941

Received copy of the foregoing concise statement of points on which appellant intends to rely this 31st day of October 1941.

BROBECK, PHLEGER &

HARRISON

Attorneys for American Trust
Company

[Endorsed]: Filed Oct. 31, 1941. [196]

[Title of District Court and Cause.]

CONDENSED STATEMENT IN NARRATIVE
FORM OF THE TESTIMONY

On April 28, 1941, and May 8, 1941, Burton J. Wyman, Special Master appointed by the district court in this matter, held hearings on the issues raised by the answer, and on June 19, 1941, on the issues raised by the objections to the plan of corporate reorganization.

At the opening of the hearing on June 19, 1941, counsel for American Trust Company moved to introduce in evidence the testimony adduced on the hearings on the issues raised by the answer. Debt-

or's counsel stated he had no objection; but objected to the admission of the testimony of American Trust Company's expert witnesses as to the present value of the real estate in its existing condition, on the ground that the proper basis of [197] valuation of the property for the purposes of the plan would be the value as improved and subdivided with duplex structures upon it, and that the existing value of the land is not material. Counsel for American Trust Company urged that the latter is the only evidence that is material; that that company cannot be compelled to enter into a speculative venture which is entirely dependent on whether or not the debtor can sell the houses for the price it indicates; that, so far as the debtor is concerned, the present value of its assets is far less than the amount of its obligations; that nobody except American Trust Company has any right to vote on said plan; that present value is the only question involved.

The Master ruled in accordance with the contention of American Trust Company, stating that the debtor had to take fixed assets as the present value, otherwise it is speculating on what maybe will happen in the future.

The debtor's counsel stipulated to the admission of the testimony adduced on the hearings on the issues raised by the answer, subject to his foregoing objection.

Thereupon discussion arose as to whether or not value should be given to a claim then being liti-

gated by the debtor in a pending suit against A. L. May and others. The Master ruled that in the absence of any showing that it is a valuable asset, he would have to say it is a speculative matter.

It was stipulated by counsel that the debtor's articles of incorporation specify as the purpose for which the debtor is formed only to carry on and conduct, in all of its branches, the business of a laundry in the City and County of San Francisco, and such other business as may be connected therewith or necessary for the prosecution thereof. [198]

The following is a condensed statement in narrative form of the testimony.

MR. GEORGE H. THOMAS, JR.,

called as a witness by American Trust Company, testified:

I have engaged in real estate with Baldwin & Howell for over 20 years, and have had considerable experience in appraising real property in and around San Francisco. I assisted in the appraisal of all rights of way and terminals of the San Francisco-Oakland Bay Bridge, and was employed by the United States Government and the City and County of San Francisco, and have been a member of the County Board of Equalization for the last 10 years. I have appraised property for the San Francisco Bank, the Crocker Bank, the Crocker Estate,—in all in excess of \$100,000,000 worth of property.

(Testimony of George H. Thomas, Jr.)

I am familiar with the property of the debtor corporation subject to American Trust Company's mortgage trust deed, and have appraised it. My appraisal is \$30,000.

In arriving at the value, I have taken into consideration properties in the vicinity that have been sold, and I took into consideration the highest and best use the property might be put to, the location, and all the elements pertaining to fair market value of the property.

The highest and best use to which the land can be put is commercial—a skating rink, an ice rink, or some kind of an amusement center—a special use where the people who used it could not afford to put much money into the land and still want a fairly good location. I took into consideration the potentialities so far as residential is concerned. Due to the fact the Federal Housing would not lend money on property in the vicinity due to its blighted condition and type of residents, I think the highest and best use would be for some specialized line. A subdivision of the property would decrease its value, because of the cost [199] entailed in subdividing, the amount of available property, and the fact that it would cost as much to build bungalows or flats there as it would in Pacific Heights, and the revenue would be very limited in proportion to what you could get in a better district.

There was a sale on the northeast corner of Steiner and Eddy, across the street from the block

(Testimony of George H. Thomas, Jr.)

containing the debtor's property, in 1937. That property is 82' 6" by 82' 6", improved with flats, and sold for \$6,500.00.

In valuing the debtor's property, I have not placed any value on the structures on it. They are very, very old, and more of a liability.

I appraised the property on the north west corner of Turk and Fillmore, immediately adjacent to the property in question. This corner was sold about 90 days ago, I think, for \$65,000.00, without referring to my records. It is 130' 6" on Turk by 85' on Fillmore. It is not at all comparable to the property in question.

The property at Turk and Steiner, also immediately adjacent to the property in question, was sold about Sept. 20, 1939, for \$6,300.00. I do not know of any more recent sale since it has been developed as a gas station.

The property at the northwest corner of Turk and Fillmore is definitely not comparable. Fillmore Street is a business street with some retail business on it. This corner was sold in August 1940 for \$62,500, and is not comparable from an income point of view. It is entirely different.

The debtor's land in question is assessed for \$30,240.00, and the improvements for \$1,950.00. My opinion is that a liberal value is \$30,000.00, although I have been associated with the Assessor for 10 years as advisory counsel. It is not a question of value so much as apportionment of assessment of

(Testimony of George H. Thomas, Jr.)

property in the district. It is assessed proportionately. Assessed value does not denote market value.

[200]

As between the land and improvements on the northwest corner of Turk and Fillmore, I think 75 per cent of the value would apply to the land. That is just an offhand opinion.

The debtor's improvements have not been kept up at all. For a number of years Baldwin & Howell have tried in every possible way to create a buyer for the debtor's property and have been unsuccessful.

The northwest corner of Fillmore and Turk is improved with stores and a hotel upstairs. It is tenanted. The improvements may be 35 or 40 years old, but have been well kept and modernized. The stores are really modern. I would say the income from the property is \$850 to \$1,000 per month; that would be just a guess.

MR. B. A. BANKER,

called as a witness by American Trust Company,
testified:

I have been a real estate broker for 35 years in San Francisco, have had considerable experience appraising properties, am familiar with the debtor's property in question, and made a joint appraisal of it with Mr. Thomas. Our appraisal was \$30,000.00 as the market value.

I place a price on the property of 52 or 53 cents a square foot. We took into consideration what the property might be sold for if it was subdivided and utilities put in. We subdivided the Odd Fellows Cemetery and the Masonic Cemetery. I think they are located better than this. We sold the Odd Fellows off at about 65 cents a square foot, and the Masonic at about 90 cents, after the utilities were in. I would imagine the cost of placing utilities in this property, if it were subdivided, would cost between \$12,000 and \$15,000. The area is about 56,000 or 57,000 square feet. In my opinion, you could not subdivide the property and get \$30,000.00 for it.

[201]

I don't think the property would be worth more a square foot in subdivision than at the present time, and you would go to the cost of putting in utilities and connections before selling it. The figure of \$15,000 for the utilities is largely an offhand opinion: I could figure the cost. Last fall my company sold a lot on Sutter near Divisadero, 106' by 137' 6"—about 14,000 square feet—for \$5,000.00, which was 36 or 37 cents a square foot.

In arriving at the valuation of the debtor's property in question, I considered the value of the property at Turk and Steiner; but gave no consideration whatever to Turk and Fillmore, because it is a piece of commercially leased business property that paid over 10 per cent on the price it sold for.

I have heard the area in which the property in question is situate called the blighted area. But I

(Testimony of Mr. B. A. Banker.)

did not say that it was a blighted area. I think a blighted area is one in which it is not sound economically to build a new building or make new improvements, an account of the surrounding improvements. [202]

MR. EDWARD AHNEFELD,

called as a witness by American Trust Company, testified:

My occupation is Assistant Cashier American Trust Company; and I am familiar with the indebtedness of the debtor to that bank.

As of April 28, 1941, the balance of principal of the bank loan is \$25,810.52; accrued interest \$8,391.26; interest on delinquent interest \$918.75; advances for taxes \$3,944.79; cost of a partial reconveyance \$5.00; default notices \$12.00; advertising costs \$23.50; interest on advances \$258.46; total \$39,364.28. This does not include the 2nd instalment of 1940-1941 taxes, amounting to \$819.48, which have not been paid.

The last payment of any nature was \$500, January 28, 1940. The trust deed covers all the debtor's real property, except the 25-foot lot on Steiner Street.

The bank was paid \$2,339.60 on December 29, 1938; \$1,834.95 in March 1939; \$5,900.00 about October 1939, in consideration of a partial release; and \$500 on January 28, 1940. The payments of

(Testimony of Mr. Edward Ahnefeld.)

March 1939 and January 1940 were applied to tax advances; that of October 1939 to principal. The debtor has not paid taxes on this property for more than 3 years, aside from repayments on account of tax advances we made. [203]

MR. CHARLES M. BUFFORD,

called as a witness, first by American Trust Company, and afterwards by the debtor corporation, testified:

In 1940, total rentals received by the debtor were \$1,655, and percentage on the parking concession was \$487.82. A small portion of that amount—probably not over \$125—came in on the Steiner Street property. So the net on the property subject to American Trust Company's mortgage trust deed was between \$2,000 and \$2,100.

Expenses of the property were \$138.64; payment to American Trust Company \$500; operating expenses of the debtor about \$160 per month, consisting of \$150 per month salary to myself, and \$10 per month miscellaneous expense.

I am the principal stockholder of the debtor, holding 696 shares out of 1,000 shares of capital stock. The debtor operated a laundry until November 12, 1938.

Two years prior, the company had made a conveyance to a trustee for the mutual benefit of its

(Testimony of Mr. Charles M. Bufford.)

creditors and the company, and on November 12, 1938, liquidated it. As a result, everything was paid off except the real estate mortgages.

Since 1938 we have had real estate, and remaining assets that had to be collected, consisting of machinery and accounts receivable. At the present time, there are 2 conditional sales contracts of machinery only, outstanding, others having been heretofore liquidated. Total receipts for 1940 were about \$3,900.

I am an attorney, and I think I devoted about half of my time during 1940 to the debtor's business. [204]

The accounts in connection with the assignment to the trustee have not as yet been closed: there is a suit pending against him: it took a great deal of time to get up the material for the suit. A contract with Robert E. Hatch, an attorney, to prosecute that suit was made in October or November 1940, although the suit was not filed until after the petition for corporate reorganization was filed.

I have been an officer of the debtor corporation since 1901.

The monthly rentals collected by the company for 3 months from January 1, 1941, to March 31, 1941, averaged \$226 per month.

The expenses in connection with the operation of the debtor's business are my salary of \$150 per month, miscellaneous office expenses, and fire insurance, but no other employees.

(Testimony of Mr. Charles M. Bufford.)

In the last year before the filing of the debtor's petition, its business consisted of the sale of laundry machinery and equipment, collection of outstanding accounts, the renting of real property, the fitting out of a parking lot on the property, and an effort to put the property to a more beneficial use or to sell it.

At the time of the filing of the debtor's petition, the sale of the property subject to the mortgage trust deed in favor of American Trust Company had been noticed by it.

In my opinion, it is possible for the debtor corporation to be reorganized in such a manner that it may be continued as a regular business.

I have knowledge of sales in the block containing the property in question. The lot at the corner of Turk and Steiner, with a frontage on Turk Street of 65' and on Steiner of 87' 6", was sold to L. R. Levin in the fall of 1939 for \$6,300.00. Mr. Levin built a gas station, and resold to E. G. Kimball the fore part of 1940. The deed has \$23,000 worth of Internal Revenue Stamps on it. He was asking \$18,000.00, and the rise in price from \$18,000.00 [205] to \$23,000, as shown by the stamps, is due to a trade-in he made. The oil station cost a little less than \$8,000 to build. The lot at the corner of Turk and Fillmore, with a frontage of 130' 9" on Turk and 85' on Fillmore, was sold to Gussie Gross on August 2, 1940. The testimony already given here is that the price was \$62,500.00. I have 2 offers on

(Testimony of Mr. Charles M. Bufford.)

the debtor's parcel on Steiner Street—25-foot front and 87' 6" in depth—, title to which is now in the debtor corporation, one from Wm. F. Rieger of \$2,500.00, one from the holder of the mortgage trust deed thereon to take it in satisfaction of her trust deed. There have not been any other sales in the block within the last 5 years that I know of.

I have been buying and selling land in the block, as president of the debtor, for 20 years; and prior to that, when we made some other real estate transactions in the block, was a director of the company. I think the property covered by American Trust Company's trust deed is worth a dollar a square foot. I base this on the value of the surrounding property. This offer I have for the Steiner Street property is at the rate of \$1.10 per square foot. The Fillmore Street frontage, including a very old building, was sold at almost \$6 per square foot. The site of the oil station was sold by me in the fall of 1939 at \$1.10 a square foot; and it has since sold, from Levin to Kimball, for considerably more than that. The diagonal property in the block from Steiner to Pierce, Turk to Golden Gate, changed hands about 3 years ago at a little over a dollar a square foot. Real estate in that particular neighborhood shades off in value from Fillmore Street. When the Stafford appraisal was put on property in that block 15 years ago, his committee put a value of about 50 per cent more on land in the block

(Testimony of Mr. Charles M. Bufford.)

adjoining Fillmore than he did in the block between Steiner and Pierce. [206]

The debtor's proposed plan of reorganization is as follows. The average width of the debtor's land, running through a distance of 275 feet from Turk to Eddy, is about 200 feet. The proposal is to put a street 50 feet wide through from Turk to Eddy, and put so-called duplexes on 25-foot lots on either side, thus dividing the property into lots 70 feet in depth, with an additional lot on Turk Street, where the property has additional width. The lots would comply with the requirements of The Federal Housing Authority for housing loans. The buildings would cost between \$6,500 and \$7,000 per unit, and would sell at a figure, considering the rentals available, that would net \$2,000 per lot to the debtor. There being 23 lots, 4 of them corner lots, the gross would be in excess of \$46,000. We have an architect, George E. Ralph, who has drawn preliminary plans for the buildings, a contractor who is willing to go ahead, a street contractor who has figured the street work, and a realty broker who believes he will be able to market the houses as completed. We believe that through this plan, it will be possible to retire American Trust Company's loan, and also realize an equity for the debtor corporation. The plan has been figured thoroughly. I believe all figures involved are legitimate, and the costs are appropriate to that neigh-

(Testimony of Mr. Charles M. Bufford.)

borhood. The street, once laid out, will form a little community of its own.

I have estimates of the expense of constructing such a street as I have outlined, and of doing the utility work. They run between \$3,000 and \$4,000. We propose a street with a paved section 26 feet wide, which is the right width for a small street like that according to the Street Department of the Board of Public Works. The sewer work is only a small branch sewer to connect with the main sewer on Turk Street, and there is no grading to be done.

[207]

The assignment by the debtor to A. L. May was made under date of May 29, 1936. The recital therein that the company was unable to pay its debts was true in the sense that it had not got the ready cash to pay its debts, not in the sense that it did not have assets and property sufficient to pay.

Ever since the trustee under that assignment shut down the business, the only business in which the debtor has been engaged has been the liquidation of its assets and the management of its real estate.

Whether, after the plan of reorganization is carried out and the lots sold, the company will go out of business, is hard to say. That is a matter for the future. It is conceivable that the company might liquidate its debts and still continue to hold a building.

The company does not intend longer to engage in the business for which it was originally incorpo-

(Testimony of Mr. Charles M. Bufford.)

rated, unless one so interprets the provision of its articles of incorporation, "and other business connected therewith", the company having been engaged in real estate at the time the articles were filed back in 1875, and always having been at all times ever since.

The Federal Housing Authority said they would extend loans; they so told Mr. Ralph, the architect.

The property diagonally across the corner of Fillmore and Steiner was sold to Piombo Bros. at \$1.10 a square foot. It is a corner lot, and inside property, just like the debtor's property. The sale to Piombo Bros. included the corner, and a large section of land further up the block.

There are no corner lots on the property now subject to American Trust Company's mortgage. An advantage of the subdivision I propose is that it will create 4 corner lots. [208]

I based my statement that the street work can be put in for not to exceed \$4,000 on my investigation of the cost of the street work. I investigated from the Street Department of the Engineer's Office in the City Hall what was necessary, and was informed that a 26-foot pavement was satisfactory with the city authorities. Then I ascertained the cost of the various elements that went into a street of that width.

I have dealt in real estate and studied real estate values in the neighborhood where the property in question is situate quite thoroughly. I have both

(Testimony of Mr. Charles M. Bufford.)

bought and sold real estate in the block in question. I sold a parcel on Fillmore Street in 1918, with a frontage of 22 feet on Fillmore, 85 feet north of Turk, at a price of about \$600 per front foot. The debtor was owner. I sold to California Baking Company. I sold the corner of Turk and Fillmore, with an 85-foot frontage on Fillmore and 130 feet on Turk in 1923. It belonged to the debtor. Then I bought property in that block I bought the Steiner Street lot subject to Mrs. Brownfield's trust deed, at public auction. I have personal knowledge of a sale in the block above to Piombo Bros., the draying company: I obtained information from the records, the revenue stamps, the deeds, and other sources.

A shallow lot is worth more per foot in a city than a deep lot, owing to the fact that it has more frontage. The lots as outlined in the plan, will have a value of about \$2,000 per lot. Improved as outlined in the plan, they will sell for about \$10,000 a lot. [209]

The land in the district is improved with other residence property. There is, across the street from the proposed development, a row of flats. Next door to the west on Eddy Street are 2 flats. To the east, from Fillmore to Webster, Eddy to Turk, there are a number of apartment houses. There are other residences both on Eddy and Turk,—to the west, one side of the block is occupied by Foster & Kleiser, the other side partially by residences. Across the street, a modernization program of the

(Testimony of Mr. Charles M. Bufford.)

flats I spoke of is going on. In the last 6 months the flats immediately to the west have been modernized.

The demand for residence property is very good: the vacancies in the neighborhood, as I checked them, are less than 10 per cent.

Received a copy of the foregoing condensed statement in narrative form of the testimony this 31st day of October 1941.

BROBECK, PHLEGER &
HARRISON

Attorneys for American Trust
Company

[Endorsed]: Filed Oct. 31, 1941. [210]

District Court of the United States
Northern District of California

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD ON APPEAL

I, Walter B. Maling, Clerk of the District Court of the United States, for the Northern District of California, do hereby certify that the foregoing pages, numbered from 1 to 213, inclusive, contain a full, true, and correct transcript of the records and proceedings in the matter of San Francisco Laundry Association No. 33553 L, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of Twenty-three and 75/100 and that the said amount has been paid to me by the Attorney for the appellant herein.

In witness whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 29th day of November A. D. 1941.

(Seal)

WALTER B. MALING

Clerk

E. H. NORMAN

Deputy Clerk

[Endorsed]: No. 9985. United States Circuit Court of Appeals for the Ninth Circuit. San Francisco Laundry Association, a corporation, Appellant, vs. American Trust Company, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed November 29, 1941.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

Bankruptcy, Ch. X.

U. S. C. C. A. No. 9985

In the Matter of

San Francisco Laundry Association,
a corporation,

Debtor.

San Francisco Laundry Association,

Appellant,

vs.

American Trust Company,

Appellee.

CONCISE STATEMENT OF POINTS, AND
DESIGNATION OF THE PARTS OF THE
RECORD, ON WHICH APPELLANT IN-
TENDS TO RELY.

The following is a concise statement of the points on which the appellant intends to rely on this appeal:

1.

The Special Master's failure to find on the issues raised by the answer of American Trust Company to the petition may be justified and explained only on the ground that said answer was not filed within the time prescribed by Chapter X, and for that reason was a nullity: in that view of the case, the allegations of the petition must be deemed ad-

mitted for all the purposes of the case: in the event said answer is deemed to have been filed in time to possess validity, the Special Master's Report and Certificate is fatally defective in that it wholly fails to find on the issues tendered by the answer.

2.

It is clear that the plan of corporate reorganization proposed by appellant May 31, 1941, is fair and equitable within the meaning of Chapter X, and of the judicial standards that have been enunciated; and to refuse to approve it was an abuse of discretion.

3.

It is clear that said plan is feasible within the meaning of Chapter X, and of the judicial standards that have been enunciated; and to refuse to approve it was an abuse of discretion.

4.

The finding of the Special Master, approved by the district court, that each and all of the objections of American Trust Company to said plan, are true, is prejudicially erroneous, and appellant has excepted to it, in each of the following respects:

a. Insofar as the same relates to that portion of Objection 1, alleging that the debtor is insolvent, said finding is contrary to the weight of evidence, and to said company's admissions resultant from its failure to answer within the time prescribed by law.

b. Insofar as the same relates to that portion of Objection 1, alleging that said plan contemplates the realization of something by the debtor at American Trust Company's expense, said finding is not supported by evidence, and is contrary to the express provisions of said plan.

c. Insofar as the same relates to that portion of Objection 2, alleging that the obligations due from the debtor to American Trust Company far exceed the value of the property hypothecated to said company, said finding is contrary to the weight of evidence, and to said company's admissions resultant from its failure to answer within the time prescribed by law.

d. Insofar as the same relates to Objection 3, alleging that said plan discriminates unjustly in favor of the holder of the mortgage trust deed on the debtor's smaller parcel of land, said finding is not supported by evidence, and is contrary to the express provisions of said plan.

e. Insofar as the same relates to Objection 4, alleging that said plan provides for the scaling down of the indebtedness owing American Trust Company, said finding is not supported by evidence, and is contrary to the express provisions of said plan.

f. Insofar as the same relates to Objection 5, alleging that said plan contemplates a speculative venture for which there is no reasonable prospect of success, said finding is not supported by evidence, is directly contrary to the only evidence in

the record touching said matter, and is contrary to the express provisions of said plan.

5.

Certain of the objections to said plan, raised by American Trust Company, and deemed important, if not controlling, by the Special Master and the district court, are without force or validity:

a. The issue raised by Objection 1, whether or not the debtor is insolvent in the absolute sense, is wholly immaterial.

b. The point made in Objection 2, that said plan contemplates the creation of a prior encumbrance upon the property hypothecated to said company, is wholly immaterial, as the same is to be created for the value of labor and materials to be furnished to enhance the value of the property.

c. The point made in Objection 3, that said plan discriminates unjustly in favor of the holder of the mortgage trust deed on the debtor's smaller parcel of land, if valid, goes only to a minor detail of the plan; and in the event it were sustained, could and should be remedied by amendment to said plan, and is not sufficient ground for rejection of said plan.

6.

The appellant excepts to the ruling of the Special Master as prejudicial, that the only question of land value before him was the then present value of the parcel of land subject to American Trust Company's mortgage trust deed in its then present con-

dition, and his refusal to consider its value were said plan carried out.

7.

The refusal of the district court to grant appellant leave to amend its said plan, or to present a different plan after disapproval of said first plan, was prejudicial error, no opportunity for amendment of said first plan, nor for substitution of a different plan, having been granted at any stage of the case.

The following is a designation of the parts of the record on which the appellant intends to rely on the appeal:

Index

(pages refer to pages of typewritten transcript
on appeal)

Affidavit in support of motion to amend decree disapproving Plan of Reorganization and dis- missing proceedings	182
Affidavit as to amount involved in appeal	188
Answer of American Trust Company to Peti- tion for Reorganization	120
Certificate and Report of Special Master on is- sues raised by Answer to Petition for Reor- ganization and Objections to Plan of Reor- ganization	106
Certificate of Clerk of district court	214
Concise Statement in narrative form of the Testimony	197

Concise Statement of Points on which appellant intends to rely	194
Decree disapproving Plan of Reorganization and dismissing proceedings	179
Exceptions by appellant to Certificate and Report of Special Master	176
Notice of Appeal	186
Notice of Motion to amend decree disapproving Plan of Reorganization and dismissing proceedings	180
Objections of American Trust Company to Plan of Reorganization	159
Order approving Petition as properly filed	116
Order denying Motion to amend decree disapproving Plan of Reorganization and dismissing proceedings	185
Orders of Reference to Special Master	125, 160
Petition of debtor for Corporate Reorganization	106
Plan of Reorganization	148

The following is the designation:

1.

Beginning with page 106 and ending with line 3 of page 115 thereof.

2.

Beginning with the 3rd line from the end of page 115 and continuing to the end of page 125 thereof.

3.

Beginning with the words, "In the meantime", in line 11 of page 148 to the 4th line of paragraph I on page 149 thereof, and ending with the words, "this plan of reorganization", in said line.

4.

Beginning with paragraph II on page 150 and continuing to the 10th line from the end of page 160, ending with the words, "United States District Judge" in said line.

5.

Beginning with the word, "Although", in line 9 of page 174, and including the three paragraphs beginning with said word, and continuing as far as the words, "Special Master's Fees and Expenses", on said page.

6.

Pages 176 to 189 thereof, inclusive.

7.

Pages 194 to 202 thereof, inclusive.

8.

Pages 204 to 210 thereof, inclusive.

9.

Page 214 thereof.

Provided, nevertheless, that titles of court and cause, and any other formal portions, shall be omitted from documents commencing on pages 176,

179, 180, 182, 185, 186, 188, 194, 197 and 214 of said record.

CHARLES M. BUFFORD

Attorney for appellant

December 1, 1941.

Received a copy of the foregoing Concise Statement of Points, and Designation of the parts of the record, on which Appellant intends to rely, this 1st day of December 1941.

BROBECK, PHLEGER &

HARRISON

Attorneys for American Trust
Company

[Endorsed]: Filed Dec. 2, 1941. Paul P. O'Brien,
Clerk.

United States Circuit Court of Appeals
for the Ninth Circuit.

No. 9985

SAN FRANCISCO LAUNDRY ASSOCIATION,

a corporation,

Appellant,

vs.

AMERICAN TRUST COMPANY,

a corporation,

Appellee.

DESIGNATION OF MATERIAL UNDER
RULE 19.

Comes now American Trust Company, the appellee in the above-entitled cause, and pursuant to sub-

division 6 of rule 19 of the rules of this Court, designates as material to the consideration of this cause the following additional portions of the record herein, and requests that the same be printed in full, to wit:

The whole of the "Certificate and Report of Special Master on issues raised by answer of American Trust Company to petition for corporate reorganization and objections of American Trust Company to proposed plan of reorganization," which said Certificate is set forth on pages 106 to 175 of the original certified record herein.

Dated: December 13, 1941.

HERMAN PHLEGER

MAURICE E. HARRISON

HOWARD J. LINN

A. M. DREYER

Counsel for Appellee.

[Endorsed]: Filed Dec. 15, 1941. Paul P. O'Brien,
Clerk.

No. 9985

United States
Circuit Court of Appeals

For the Ninth Circuit

SAN FRANCISCO LAUNDRY ASSOCIATION,
a corporation,

Appellant,

vs.

AMERICAN TRUST COMPANY,

Appellee.

BRIEF OF APPELLANT

CHARLES M. BUFFORD,

1450 Turk St.,

WEst 1941

San Francisco, Cal.

Attorney for Appellant.

FILED

JAN 28 1942

PAUL P. O'BRIEN,

CLERK

No. 9985

United States
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Subject Index

	Pages
Jurisdictional Statement	1
Statement of the Case.....	2
Specification of Errors.....	10
Abuses in Appellee's Designations of Records.....	13
Argument of the Case.....	16
1. The appellee's answer too late: the failure to find thereon.....	17
2. The objections to the proposed plan of reorganization are unsound: the findings and conclusions to the contrary are erroneous	18
(a) The finding of insolvency not sustained by evidence.....	18
(b) The finding that the plan scales down the appellee and gives the debtor something at its expense erroneous.....	22
(c) The finding of unjust discrimination in the plan as between creditors erroneous	24
(d) The finding that the plan is speculative and without reason- able prospect of success erroneous.....	25
(e) The finding of insolvency outside the issues.....	28
(f) The finding that the plan creates an encumbrance prior to appellee's without force of validity.....	30
(g) The exclusion from consideration of value were the plan adopted erroneous	31
3. (a) The plan is fair and equitable.....	33
(b) The plan is feasible.....	37
4. The refusal to the debtor of leave to amend the plan or pre- sent an alternative plan erroneous.....	38
Conclusion	44

Table of Cases

	Pages
333 N. Michigan Av., CCA 7, July 1, 1936, rh. dn. July 24, 1936	
84 Fed. 2d 936.....	27
<i>Bush Terminal</i> , CCA 2, July 6, 1936, 84 Fed. 2d 984.....	42
<i>Case v. Los Angeles Lumber</i> , Nov. 6, 1939, 308 U. S. 106, 60	
S. C. 1, 84 L. 22, rh. dn. Dec. 4, 1939, 308 U. S. 637, 60 S. C.	
258, 84 L. 529.....	30, 34, 42
<i>Central Forging</i> , Dist. Ct. Pa., Apr. 15, 1941, 38 FS 18.....	28, 36
<i>Central Funding</i> , CCA 2, Feb. 11, 1935, 75 Fed. 2d 256.....	29
<i>Central States Life v. Koplar Co.</i> , CCA 8, Dec. 17, 1935, rh. dn.	
Feb. 5, 1936, 80 Fed. 2d 754.....	40
<i>Chapman Bros. Co. v. Security-1st Bank</i> , CCA 9, Apr. 10, 1940,	
111 Fed. 2d 86.....	34
<i>City Bank v. Irving Trust</i> , Jan. 4, 1937, 299 U. S. 433, 57 S. C.	
292, 81 L. 324.....	23, 40
<i>Consol. Rock Products v. DuBois</i> , Mch. 3, 1941, 312 U. S. 510,	
61 S. C. 675, 85 L. 982.....	33, 34
<i>Dollar Dry Cleaning</i> , Dist. Ct. Conn., June 21, 1940, 33 FS 861	29
<i>Greyling Realty Corp.</i> , CCA 2, Jan. 7, 1935, 74 Fed. 2d 734,	
cert. dn. Apr. 1, 1935, <i>Troutman v. Compton</i> , 294 U. S. 725,	
55 S. C. 639, 79 L. 1256.....	39
<i>John Hancock Ins. Co. v. Bartels</i> , Dec. 4, 1939, 308 U. S. 180,	
60 S. C. 221, 84 L. 176.....	29, 41
<i>Kuehner v. Irving Trust</i> , Jan. 4, 1937, 299 U. S. 445, 57 S. C.	
298, 81 L. 340.....	23, 35
<i>M. M. Sterba</i> , CCA 7, Jan. 5, 1935, 74 Fed. 2d 413.....	43
<i>National Public Service Corp.</i> , CCA 2, Jan. 15, 1934, 68 Fed.	
2d 859	15
<i>New Rochelle</i> , CCA 2, June 3, 1935, 77 Fed. 2d 881.....	27, 29
<i>Radio-Keith-Orpheum</i> , CCA 2, July 18, 1939, 106 Fed. 2d 22,	
cert. dn. Jan. 2, 1940, <i>Cassel v. R-K-O</i> , 308 U. S. 622, 60 S. C.	
377, 84 L. 519, and <i>Stirn v. Atlas</i> , 308 U. S. 622, 60 S. C. 380,	
84 L. 520, rh. dn. Feb. 5, 1940, 309 U. S. 694, 60 S. C. 512,	
84 L. 1035.....	35
<i>Reb Holding Co.</i> , Dist. Ct. Wis., Nov. 19, 1940, 35 FS 716.....	31
<i>U. S. v. Bekins</i> , Apr. 25, 1938, 304 U. S. 27, 58 S. C. 811,	
82 L. 1137.....	30
<i>Warren Bros. Co.</i> , Dist. Ct. Mass., May 26, 1941, 39 FS 381.....	32
<i>Wright v. Union Central Life</i> , May 31, 1938, 304 U. S. 502, 58	
S. C. 1025, 82 L. 1490.....	41
<i>Wright v. Vinton Branch</i> , Mch. 29, 1937, 300 U. S. 440, 57 S. C.	
556, 81 L. 736.....	24

Citations of U. S. Constitution

	Pages
5th Amendment (Due Process)	23, 30, 36

Citations of Bankruptcy Act

Sec. of Act	Sec. of 11 USC	Pages
2	11	2
24a	47a	2
74	202	43
75	203	23, 29, 40, 41, 43
77B(c) (8)	207(c) (8)	42
102	502	2
116(2)	516(2)	31, 36
121	521	2
128	528	2
137	537	17
161	561	17
216(2)	616(2)	25, 36
216(3)	616(3)	25
216(10)	616(10)	37
236	636	42
77B	207	23, 29, 32, 39
Ch. X	501 seq.	1, 2, 13, 23, 29, 32, 36, 39, 44

Citations of Rules, 9th Circuit

Rules	Pages
19(6)	15, 16

Citations of Rules Civil Procedure

Rules	Pages
15(a)	39
52(a)	18
53(a)	18
75(e)	13, 14

Citations of Congressional Record

	Pages
Sen. 75th Cong. 3rd Sess. p. 8679.....	39
House 75th Cong. 1st Sess. p. 8649.....	39

APPELLANT'S BRIEF**JURISDICTIONAL STATEMENT**

On February 6, 1941, the debtor filed its verified petition for corporate reorganization, under Ch. X of the Bankruptcy Act, in The Southern Division of the United States District Court for the Northern District of California, and the same was assigned for hearing before Hon. Harold Louderback.

The petition alleged facts showing that the debtor is a corporation; that it has had its principal place of business at San Francisco within said district for more than 6 months immediately preceding the filing of the petition; that it is such a corporation as is authorized to file a petition under Ch. X; that it is unable to pay its debts as they mature, and desires that a plan of reorganization be effected under Ch. X; that no plan of reorganization, adjustment or liquidation affecting the debtor's property is pending, except a forced sale under a power of sale in a mortgage trust deed executed by the debtor.

Thus the district court had jurisdiction of the proceeding under secs. 2, 102, and 128 of the Bankruptcy Act, 11 USC 11, 502 and 528.

The present appeal is from a final decree of the district court, disapproving the plan of corporate reorganization presented by the debtor under Ch. X, and dismissing the proceedings; and from an order of the district court, subsequently made, refusing to amend said decree so as to grant said debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections.

The notice of appeal is supported by an affidavit setting forth that the amount involved in said decree and in said order, each respectively, is in excess of \$500.

This court has jurisdiction of the appeal under secs. 24a and 121 of the Bankruptcy Act, 11 USC 47a and 521.

STATEMENT OF THE CASE

From the debtor's schedules accompanying its petition for corporate reorganization, it appeared that the debtor's principal assets were two adjoining parcels of real property, the larger containing about 55,000 sq. feet., or about half the block bounded by Fillmore, Turk, Steiner and Eddy Streets, San Francisco, the smaller containing only about 2,000 sq. ft. The larger parcel was subject to a mortgage trust deed in favor of American Trust Company for upwards of \$30,000, the smaller to a mortgage trust deed in favor of Florence B. Brownfield for upwards of \$3,000. The debtor's only liabilities, with trifling exceptions, were the obligations so secured. The debtor alleged it possessed a substantial equity in the larger parcel, and, in addition listed other assets valued at more than \$2,000.

On Feb. 21, 1941, an order of the district court was filed, approving the petition as properly filed under Ch. X, temporarily continuing the debtor in possession, fixing Apr. 7, 1941, as the time of a hearing to determine whether or not the debtor should be continued in possession thereafter, and Apr. 14, 1941, as the time for the debtor to file a plan of reorganization, and prescribing powers, duties and procedure.

On Apr. 14, 1941, American Trust Company filed its verified answer to the petition.

Therein it alleged that the debtor was indebted to it in excess of \$39,114; that the fair market value of the property subject to its mortgage trust deed was far less than the obligations secured thereby; that there is no equity in said property for

the debtor, its creditors, or stockholders; that no plan of reorganization can be effected without the consent of said company; that it has the constitutional right to have the property covered by its trust deed subject to the payment of the indebtedness secured thereby; that the petition was filed for no other purpose than to hinder and delay it in the pursuit of its just rights and remedies; that the debtor has neither the working capital nor equipment necessary to enable it to carry on business as a going concern; that it is impossible for the debtor to be rehabilitated as a going concern; that the debtor is unable to pay his debts as they mature; that the debtor is insolvent; that the debtor's petition was not filed in good faith; that the only businesses which the debtor may lawfully carry on under the provisions of its Articles of Incorporation are the business of a laundry and such other businesses as may be connected therewith or necessary for the operation thereof. The answer admitted that the trustee under said trust deed proposed to sell the property subject thereto for the purpose of satisfying the obligations secured thereby. It prayed that the debtor be not continued in possession, and that the proceedings be dismissed or a trustee appointed.

Neither the debtor's other principal creditor, Florence B. Brownfield, nor any one else, answered.

The issues raised by the answer of American Trust Company were referred to Burton J. Wyman as Special Master, to take testimony and report to the court; and the said Special Master held hearings on the issues thus referred, and the questions in issue were submitted to him for his decision.

Thereafter, on May 31, 1941, the debtor filed with the district court its proposed plan of corporate reorganization.

The crucial provisions of said plan (Rec. pp. 61 to 75) are as follows:

Para. V proposes that the real property subject to American Trust Company's mortgage trust deed be divided into 23 lots, each of 25-foot frontage and desirable depth, 22 of them to face a new public street, 50 feet in width, dedicated and constructed across said parcel, in conformity with a subdivision plat attached to said plan (Rec. p. 75). It also proposes that each lot be improved by the construction thereon of a duplex dwelling with ground-floor garage.

Para. VII(b) provides for the issuance to American Trust Company of a new mortgage trust deed for the principal sum of \$29,795.81, being the amount of the principal of its demand, \$25,810.52, and of its cash advances, \$3,985.29, the same to bear interest at the rate of 4½ per cent per annum, and to cover all property now subject to its demand except said new public street; and for the issuance to American Trust Company of preferred capital stock of the debtor, with absolute priority over its other capital stock, for the residue of its demand, mostly unpaid interest.

Para. V also sets forth: The parcel of real property subject to American Trust Company's trust deed is the largest at present available for a housing development in the entire Fillmore shopping district of San Francisco, and is close to the most desirable residential construction in the district. The duplex dwellings proposed will face their own quiet street. The project will create its own favorable atmosphere, dominate the housing trend in the immediate neighborhood, cater to those who prefer to live closer in town where distances are less and climatic conditions better, and bring a desirable class

of residents and buyers. George E. Ralph as architect, T. D. Harney as street contractor, and Theodore Patrikis as general contractor are ready, willing and able to proceed forthwith, upon the confirmation of the plan, with the construction of the first 6 of said duplex dwellings, the street work, and the installation of utilities.

Para. V further sets forth that the debtor is advised and believes that said duplex dwellings can be constructed for about \$6,500 each; but proposed, in view of present increasing construction costs, that the cost be limited to \$7,500 each; and the cost of said street work and utilities be limited to \$4,000.

Para. IV provides for the issuance by the debtor of non-interest-bearing certificates of indebtedness, to have absolute priority over all other obligations of the debtor, secured and unsecured, to be issued in payment of said building construction and street utility work.

Para. V provides that these certificates be issued against architect's certificates, as the work progresses, in an amount equal to the actual cost of such work, in the customary manner.

Para. V next provides that upon the completion of each unit of said duplexes, the same be sold for cash, at not less than an amount equal to the costs of sale, the cost of construction of the same, plus $1/23$ of the cost of street and utility work, plus $1/23$ of the principal of the new note to be given American Trust Company; that the balance of such sale price above \$1,500, upon each sale, be divided half and half between the contractor's representative and the debtor; that the debtor's share be applied to current taxes, current expenses of operation of the debtor, current interest due American Trust Com-

pany, payments on said new note to be issued to American Trust Company, and redemption of preferred stock to be issued American Trust Company as by said plan provided.

Para. V also provides that as each duplex is sold, the construction of an additional duplex be undertaken on the same terms and conditions, until all said lots shall have been so improved and sold.

Para. VII(a) provides that as the smaller parcel of real property subject to Florence B. Brownfield's mortgage trust deed in no event exceeds in value the amount of her demand, and she has indicated a desire to accept a conveyance thereof by the debtor in full satisfaction of her demand, the said parcel shall be conveyed to her in satisfaction of her demand.

The plan also contains the various miscellaneous provisions appropriate for carrying out the foregoing projects and concludes (Rec. p. 74):

"It is respectfully submitted that the foregoing plan is fair and equitable in all respects, and the debtor respectfully requests all creditors to join in a consent to this plan, so that they, as well as the debtor, will receive the maximum benefits."

Thereafter, American Trust Company filed objections to said proposed plan, on the ground that said plan is unfair and inequitable in each of the following particulars (Rec., pp. 77 and 78):

1. Said debtor is insolvent, and said plan contemplates the realization by the debtor and its stockholders and officers of money, assets, and property of the debtor at the expense of the creditor.

2. Said plan contemplates the creation of a prior encumbrance upon the property hypothecated to the creditor, not-

withstanding the fact that the obligations due from the debtor to the creditor far exceed the value of said property.

3. Said plan discriminates unjustly in favor of Florence B. Brownfield and against American Trust Company, in that it contemplates that the property hypothecated to her be conveyed to her in satisfaction of the obligations owing to her, but contemplates that the property hypothecated to American Trust Company shall be retained by the debtor.

4. Said plan provides for the scaling down of the indebtedness owing to American Trust Company.

5. Said plan contemplates that the assets of the debtor shall be used in a speculative venture for which there is no reasonable prospect of success.

It prayed that said plan be disapproved and the proceedings dismissed or the debtor adjudicated a bankrupt.

Thereafter, an order was made that the issues raised by said objections be referred to Burton J. Wyman as Special Master, to take testimony and report to the court; and in pursuance thereof the Special Master held a hearing on said objections.

At the opening of the hearing counsel for American Trust Company moved to introduce in evidence the testimony adduced on the hearings on the the issues raised by the answer. Debtor's counsel stated he had no objection; but objected to the admission of the testimony of American Trust Company's experts as to the present value of the real estate in its existing condition, on the ground that the proper basis of valuation of the property for the purposes of the plan would be the value as improved and subdivided with duplex structures upon it, and that the existing value of the land is not material. Counsel for American Trust Company urged that the latter is the only

evidence that is material; that the company cannot be compelled to enter into a speculative venture which is entirely dependent on whether or not the debtor can sell the houses for the price it indicates; that, so far as the debtor is concerned, the present value of its assets is far less than the amount of its obligations; that nobody except American Trust Company has any right to vote on said plan; that present value is the only question involved.

The Special Master ruled in accordance with the contention of counsel for American Trust Company, stating that the debtor had to take fixed assets at the present value, otherwise it is speculating on what maybe will happen in the future. (Rec. pp. 85 and 86, 116 and 117.)

The debtor's counsel stipulated to the admission of the testimony adduced on the hearings on the issues raised by the answer, subject to said objection.

At the conclusion of the hearing on the objections of American Trust Company, the matter was submitted to the Special Master.

On July 24, 1941, the Special Master issued his first and only Certificate and Report, wherein and whereby he concluded (Rec., pp. 97 and 98):

“Although there have been hearings on two different matters in connection with this debtor proceeding, I am of the opinion that the court can best deal with the pending questions on the basis of American Trust Company's prayer at the end of its objections that said plan of reorganization be disapproved and that the proceedings be dismissed or debtor adjudicated a bankrupt.

"Proceeding on the theory just stated, I find from the record that each and all of said objections are true, and I therefore conclude, as matters of law, that said objections are sufficient upon which to base an order disapproving the proposed plan of reorganization and dismissing the debtor's proceeding, or an order adjudicating said debtor a bankrupt.

"I therefore respectfully recommend that the court make one or the other of the aforesaid prayed for orders."

Thereafter the debtor filed with the district court its exceptions to said Certificate and Report (Rec., pp. 100 to 102), wherein and whereby the debtor specified the errors relied upon in this court.

On Sept. 12, 1941, the district court made and filed an order and decree as follows (Rec., pp. 103 and 104):

"The Special Master's Certificate and Report filed July 24, 1941, on the issues raised by the answer of the American Trust Company to the petition for corporate reorganization, having been submitted and fully considered, IT IS ORDERED that the said Special Master's Certificate be and the same is hereby affirmed and the exceptions thereto are hereby overruled. IT IS FURTHER ORDERED that the Plan of Reorganization be and the same is hereby disapproved and these proceedings are hereby dismissed."

On Oct. 13, 1941, the debtor moved the court to amend its said decree so as to grant said debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections, basing said motion on an affidavit filed in the district court Oct. 9, 1941, and the other files and records in the case (Rec., pp. 104 to 108).

On Oct. 22, 1941, the district court entered its order deny-

ing the debtor leave to amend its said plan or file a different plan (Rec., pp. 108 and 109).

The same day the debtor filed its appeal from said decree issued Sept. 12, 1941, and from the whole thereof, and from said order issued Oct. 22, 1941; and its affidavit setting forth that the amount involved in said decree and in said order, each respectively, is in excess of \$500.

SPECIFICATION OF ERRORS

The exceptions to the Certificate and Report of the Special Master, heretofore referred to as presented by the appellant to the district court, were that it is erroneous in each of the following respects (Rec., pp. 100 to 102):

1. In finding that the debtor is insolvent.
2. In finding that the plan of reorganization contemplates the realization by the debtor and stockholders and officers of money, assets and property of the debtor at the expense of the creditors.
3. In finding that the plan of reorganization contemplates the creation of a prior encumbrance upon the property hypothecated to the creditors.
4. In finding that the obligations due from the debtor to the creditor exceed the value of the debtor's property.
5. In finding that the plan of reorganization discriminates unjustly in favor of Florence B. Brownfield.
6. In finding that the plan of reorganization provides for the scaling down of the indebtedness owing to the creditor.
7. In finding that the plan of reorganization contemplates that the assets of the debtor shall be used in a speculative venture.

8. In finding that the plan of reorganization presents no reasonable prospect of success.

9. In that the Special Master at the hearing on the plan of reorganization considered only the present value of the security for the obligation of American Trust Company.

10. In that the Special Master at the hearing refused to consider the subdivided and improved value of the security for said obligation.

11. In that no findings of fact are made therein.

12. In that no findings of fact or conclusions of law or either of them are made with respect to the answer of American Trust Company.

The action of the district court upon such exceptions was as follows (Rec., p. 103):

"It is ordered that the said Special Master's Certificate be and the same is hereby affirmed and the exceptions thereto are hereby overruled."

Thereupon the court entered its decree disapproving the plan of reorganization and dismissing the case.

In support of its motion that the court amend its said decree so as to grant the debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections, the debtor filed the affidavit of the debtor's president, setting forth (Rec., pp. 105 to 108):

That it was affiant's and the debtor's understanding and belief, until they had notice of the court's said decree, that in the event objections to said plan were sustained, time would be afforded the debtor to amend said plan or present an alternative plan calculated to meet and remove objections, and that such leave would be granted as part of the court's order;

that for this reason and no other the debtor did not make request, specifically, for such leave in the event of such disapproval; that under the provisions of the orders of reference to said Special Master, he was not authorized to entertain amendments or different plans, and it was not appropriate or proper that the same or either of them be presented to him in the absence of a further reference to him by the district court; that affiant verily believes that a plan of reorganization can be presented that will further the purposes and meet the requirements of the law and receive the approval of the district court; that if granted said leave, the debtor will propose a plan providing for extension of maturity of the mortgage trust deeds held by the debtor's two creditors until after the end of the present National Emergency, and for certain payments thereon in the meantime, (and containing other provisions as set forth more particularly in said affidavit); that unless the debtor is granted relief, it will suffer great and irreparable injury, and the result will be shockingly unjust to the debtor's stockholders; and that said decree was taken against the debtor through its inadvertance and excusable neglect and mistake.

The action of the district court upon the debtor's motion that the court amend its decree was as follows (Rec., p. 109):

"The motion to amend order entered September 12, 1941, having been submitted and fully considered, the court finds that upon the facts as presented to the court upon the Report of the Special Master (heretofore approved), no plan could be proposed which would be acceptable under the provisions of the Bankruptcy Act, and, therefore, it is ordered that the said

motion to amend order of September 12, 1941, be and the same is hereby denied."

The debtor appealed both from said decree or order issued Sept. 12, 1941, and from said order denying leave to amend.

Thus on this appeal, not only is the question presented whether the plan actually presented was and is fair and equitable and feasible, but the broader question whether a corporation in the financial plight of the appellant is entitled to any relief at all under Ch. X of the Bankruptcy Act.

ABUSES IN THE APPELLEE'S DESIGNATIONS OF RECORDS

1

The Designation of Record on Appeal filed by the appellee, runs counter to the provision of Rule 75(e) of the Rules of Civil Procedure, that "documents shall be abridged by omitting all . . . formal portions", by requiring the captions and verifications of all documents included in the record, notwithstanding by appellant's designation said portions were omitted.

2

The Designation of Record on Appeal filed by the appellee, runs counter to the provision of Rule 75(e), that "documents shall be abridged by omitting all irrelevant . . . portions", by requiring all documents included in the record to be set forth in full, notwithstanding by appellant's designation said portions were omitted.

3

Said Designation runs counter to the provisions of Rule 75(e), that "more than one copy of any document shall be

omitted", by requiring the inclusion in said record of the portions of the Special Master's Certificate and Report, consisting only of copies of documents included in said record by appellant's designation, and a copy of the transcript of certain of the testimony, notwithstanding the 8th specification in appellee's designation requires the inclusion in said record of said transcript in its entirety.

4

Said Designation runs counter to the provision of Rule 75(e), that "a party may prepare and file with his designation a condensed statement in narrative form of all or part of the testimony", and that "any other party to the appeal, if dissatisfied with the narrative statement, may require testimony in question and answer form to be substituted for all or part thereof", by requiring by said 8th specification the inclusion in said record of a complete transcript of the proceedings taken before the Special Master, including talk as well as testimony, in addition to appellant's condensed statement thereof in narrative form, notwithstanding appellee did not make any showing that it was dissatisfied with said narrative statement in any respect, nor designate for what portion of said narrative statement said question and answer form was to be substituted.

Said 8th specification, in requiring the designation in the record of talk as well as testimony, also runs counter to the well-known rules of practice on appeals, which may be summed up thus, following the 2nd Circuit: The complete stenographic report of all the talk in court should not be included in the record on appeal. The minutes of a referee should be limited to the substance of what is conceded by the parties and what

was actually decided or done. National Public Service Corp., CCA 2, Jan. 15, 1934, 68 Fed 2d 859.

In all the foregoing respects, the appellee's designation of record on appeal is within the remedial and penal provisions of Rule 75(e), as follows: "For any infraction of this rule or for the unnecessary substitution by one party of evidence in question and answer form for a fair narrative statement proposed by another, the appellate court may withhold or impose costs as the circumstances of the case and discouragement of like conduct in the future may require; and costs may be imposed upon offending attorneys or parties."

5

The Designation of Material under rule 19(6) of this court, filed by the appellee, runs counter to said rule, in that the appellee has caused unnecessary parts of the record to be printed, as follows:

The Restraining Order issued by the district court at the time of the filing of the debtor's petition (Rec., pp. 12 and 13);

The portion of the stenographic report of the Special Master's hearings set forth on pages 28 to 60 of the Record;

The portion thereof set forth on pages 79 to 97 thereof;

Certain administrative details of the debtor's plan of reorganization, not in question on this appeal, beginning with the 8th line of page 62 of the Record, and continuing to the bottom of page 63 thereof;

The statement of Special Master's Fees and Expenses, and of papers handed to the district court by him (Rec., pp. 98 to 100).

In this respect, the appellee's designation of material under rule 19(6) is within the remedial and penal provisions of

said rule, as follows: "If the appellee shall have caused unnecessary parts of the record to be printed, such order as to costs may be made as the court shall think proper.

ARGUMENT OF THE CASE

The argument of this case proceeds in four stages:

1st. That the answer of American Trust Company to the petition for corporate reorganization was filed too late, and the allegations of the petition, showing that the debtor is not insolvent in the absolute sense, must be deemed admitted for all the purposes of the case; that if the answer is not a nullity for this reason, the Special Master's Certificate and Report is fatally defective in that it wholly fails to find upon the issues tendered by the answer.

2nd. That the finding of the Special Master that each and all the objections to the plan of reorganization, made by American Trust Company, are true, is erroneous for all the reasons set forth in the Specifications of Errors.

3rd. That on the contrary, the plan of reorganization is fair and equitable and feasible, within the meaning of the Bankruptcy Act and the decisions in pursuance thereof.

4th. That it was an abuse of discretion for the district court to refuse to grant the debtor leave to amend said plan or to present an alternative plan calculated to meet and remove objections.

1

In his only Certificate and Report, the Special Master sets forth: "Although there have been hearings on two different matters in connection with this debtor proceeding, as is shown in detail by the record herein, I am of the opinion that the

court can best deal with the pending questions on the basis of American Trust Company's prayer at the end of its objections 'that said plan of reorganization be disapproved and that the proceedings be dismissed or debtor adjudicated a bankrupt'. Proceeding on the theory just stated, I find from the record that each and all of said objections are true, and I therefore conclude, as matters of law, that said objections are sufficient upon which to base an order disapproving the proposed plan of reorganization and dismissing the debtor's proceeding, or an order adjudicating said debtor a bankrupt."

Thus, there are no findings on the issues raised by American Trust Company's answer.

This omission may be justified and explained only on the ground that the Special Master and the district court deemed the answer a nullity, for the reason that it was not filed with the time allowed by the Bankruptcy Act.

Sec. 137 of the Act, 11 USC 537, provides that an answer controverting the allegations of a petition by or against a debtor may be filed by any creditor "prior to the first date set for the hearing provided in section 161 of the Act", 11 USC 561.

The first hearing date set by the district court for the hearing provided in said section, was April 7, 1941, the date set by the court in its order approving the debtor's petition as properly filed, for a hearing to determine whether or not the debtor should be continued in possession thereafter. The answer was not filed until April 14, 1941, 7 days thereafter, and 7 days after the time allowed therefor had expired: no extension of the time for answering was ever made or applied for.

In the event the answer is held to be a nullity, the allegations of the petition, showing that the debtor is not insolvent in the absolute sense, must be deemed admitted for all the purposes of the case.

In the event this court shall rule that said answer was not a nullity though not filed within the time allowed by law, the Special Master's Certificate and Report is fatally defective in that it wholly fails to find upon the issues tendered by the answer.

The Rules of Civil Procedure provide (53(a)): "The Master shall prepare a report upon the matters submitted to him by the order of reference, and, if required to make findings of fact and conclusions of law, he shall set them forth in the report"; and (52(a)): "In all actions tried upon the facts without a jury the court shall find the facts specially, and state separately its conclusions of law thereon and direct the entry of the appropriate judgment".

It is evident, as regards the issues tendered by the answer, the Special Master and the district court wholly failed to follow the requirements of the rules quoted, and for that reason the Certificate and Report of the Special Master, and the decree of the court, dated Sept. 12, 1941, are both fatally defective, and must be reversed.

2(a)

The appellant's exceptions 1 and 4 attack the Special Master's findings, affirmed by the district court, that the allegations of Objection 1 to the plan, that the debtor is insolvent, and of Objection 2, that the obligations due from the debtor to American Trust Company far exceed the value of the security, are true (Rec., pp. 100 and 101), on the ground

that said findings are contrary to the weight of evidence, and to American Trust Company's admissions resultant from its failure to answer within the time allowed by law.

The company's failure to answer in time has already been sufficiently considered: the point here is that said findings are contrary to the weight of evidence.

The evidence on which the Special Master relied to support this finding was that of the bank's assistant cashier that the amount owing it was \$39,364.28; the testimony of two expert witnesses called by the bank that they had made a joint appraisal of the property subject to the bank's lien and that their appraisal thereof was \$30,000 as the market value; and the Special Master's statement that an expert he had consulted had placed the same value upon it.

The Master's expert was not produced as a witness, and any further reference to him therefore need not be made.

Mr. Banker, one of the bank's experts, testified that in placing the price on the property, the bank's two experts had taken into consideration what the property might be sold for if subdivided and utilities put in; that in his opinion the property could not be subdivided and \$30,000 gotten for it.

Mr. Thomas, the bank's other expert, agreed with Mr. Banker that a subdivision of the property would decrease its value because of the cost entailed in subdividing, the amount of available property, and the fact that revenue would be very limited in proportion to what could be obtained from bungalows or flats in Pacific Heights.

Mr. Thomas also testified that the Turk and Steiner corner adjoining the property in question had sold in September 1939 for \$6,300, or about \$1.10 per sq. ft., and that the Turk

and Fillmore corner adjoining had sold in August 1940 for \$62,500, or about \$6 per sq. ft, about 75 per cent of which would apply to the land.

Mr. Banker testified that in placing the price of 52 or 53 cents a sq. ft. on the property in question, they had considered the value of the adjoining Turk and Steiner corner, but not the adjoining Turk and Fillmore corner, because the latter was a piece of commercially leased business property with improvements, that paid over 10 per cent on the price it sold for. Mr. Thomas testified that the Turk and Fillmore corner was definitely not comparable, because Fillmore is a business street with some retail business on it, and the income from the improvements is perhaps \$850 to \$1,000 per month.

The condensed narrative of the testimony of Messrs. Thomas and Banker is set forth on pages 118 to 123 of the Record.

Mr. Bufford testified for the debtor that the foregoing sale of the Turk and Steiner corner was to Mr. L. R. Levin, that he built a gas station upon it at a cost of a little less than \$8,000, and resold it to Mr. E. G. Kimball the fore part of 1940, that he had asked \$18,000 for it, but had marked it up for trade-in purposes to \$23,000 before selling to Mr. Kimball (Rec., p. 126).

It thus appears that after deducting the cost of the gas station, and allowing Mr. Levin a 10 per cent profit on the transaction, there remains on the 2nd sale of the Turk and Steiner corner a land value of over \$8,000, or in excess of \$1.40 per sq. ft.

The foregoing were all the recent sales of real property in the block in question.

Thus, turning from the opinion evidence to the factual, we have an actual land value on the Turk and Steiner corner of \$1.40 per sq. ft., and on the Turk and Fillmore corner of \$4.50 per sq. ft., at about the time of the filing of the petition herein. Both parcels immediately adjoin, for a distance of 85 feet or more, the property here in question.

It is well recognized that the most weighty evidence of the present value of land is price actually and contemporaneously obtained at actual cash sales of adjacent or near-by property.

Mr. Bufford also testified that the debtor had been offered \$2,500 for its smaller parcel of land, a lot immediately adjoining the parcel subject to American Trust Company's lien. This offer amounts to \$1.10 per sq. ft., or more than twice the figure quoted by the bank's two experts. Mr. Bufford further testified that the holder of the mortgage trust deed upon the smaller parcel had offered to take it in full of her demand of upwards of \$3,500.

That the sum of \$30,000, or 52 or 53 cents per sq. ft., stated by the two experts as their opinion of value, is far too low, is also apparent from other testimony Mr. Thomas gave. For he stated that the property in question is assessed by the City and County Assessor for \$30,240, and the improvements thereon for \$1,950 additional; that he has been associated with the Assessor for 10 years as advisory counsel; that the property in question is assessed proportionately (Rec., pp. 120 and 121). The court will take judicial notice that in San Francisco assessed value is about half of fair actual value.

It should also be noted that Mr. Thomas' and Mr. Banker's testimony respecting value of the property in question, after subdivision, referred only to value thereof subdivided but

vacant, and had nothing to do with its sale value subdivided and improved as provided in the debtor's plan of reorganization or in some other adequate manner.

There has not been one single sale of land in the entire block in which the property in question is located, at a figure anywhere near as low as that given by American Trust Company's expert witnesses. What sales there have been, have been at figures from twice to eight times as high.

It is evident that the Special Master's findings in question are not sustained by the weight of the evidence, and, besides, are contrary to American Trust Company's admissions.

2(b)

The appellant also excepted (Exceptions 2 and 6) to the following of the Special Master's findings, affirmed by the district court, on the ground that they are not supported by evidence, and are contrary to the express provisions of the proposed plan of reorganization.

a. The finding that the allegation that the plan contemplates the realization of something by the debtor at American Trust Company's expense, in Objection 1 to the plan, is true:

b. The finding that Objection 4 to the plan, that said plan provides for scaling down American Trust Company's demand, is true.

As heretofore summarized (and see Rec., pp. 61 to 75, for the plan in full), the plan provides for the issuance to American Trust Company of a new mortgage trust deed for the entire principal of its demand and of all cash advances, and for the issuance to it of preferred capital stock of the debtor, with absolute priority, for the residue of its demand, mostly unpaid interest. Thus the plan provides for payment of Ameri-

can Trust Company in full before the debtor realizes anything at all, and does not scale down American Trust Company's demand in the least.

There is no evidence in the record to the contrary, and none to support these findings.

Even were the findings that the plan contemplates the realization of something by the debtor, and for the scaling down of American Trust Company's demand, supported by evidence, no valid objection to the plan could be based thereon. The very purpose of Ch. X is to make possible the realization of something by a debtor, and in the accomplishment of that purpose, to scale down the creditor's demand. The supreme Court expressly so holds.

In *City Bank vs. Irving Trust*, Jan. 4, 1937, 299 U. S. 433, 438-439, 57 S. C. 292, 81 L. 324, it declared: "The purpose of sec. 77B was to facilitate rehabilitation of embarrassed corporations by a scaling or rearrangement of their obligations and stockholders' interests, thus avoiding winding up, a sale of assets, and a distribution of the proceeds. A salient element in such a reorganization is the discharge of all demands of whatsoever sort, executory or contingent, presently due or to mature in the future."

In *Kuehner v. Irving Trust*, Jan. 4, 1937, 299 U. S. 445, 452, 57 S. C. 298, 81 L. 340, the Supreme Court added: "While the 5th Amendment forbids the destruction of a contract, it does not prohibit bankruptcy legislation affecting the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, if the statutory provisions are consonant with a fair, reasonable and equitable distribution of those assets."

In sustaining the constitutionality of the Agricultural Adjustment provisions of the Bankruptcy Act, sec. 75, 11 USC 203, known as the 2nd Frazier-Lemke Act, and the action of a district court in scaling down a farmer's indebtedness to the value of the mortgaged property, the Supreme Court, reversing 3 Courts of Appeals and overruling 14 other decisions of lower courts, said: "The mortgagor is in default, but it is not therefore to be assumed that he is a wrongdoer, or incompetent to conduct farming operations. The legislation is designed to aid victims of the general economic depression." The court added: "The farmer's proceeding in bankruptcy for rehabilitation, resembles that of a corporation for reorganization." *Wright v. Vinton Branch*, Mch. 29, 1937, 300 U. S. 440, 466, 467, 57 S. C. 556, 81 L. 736.

2(c)

Likewise the debtor excepted (Exceptions 5) to the Special Master's finding, affirmed by the district court, that the allegations of Objection 3 are true, on the ground that said finding is not supported by evidence, and is contrary to the express provisions of said plan. This Objection is that the plan discriminates unjustly in favor of the holder of the mortgage trust deed on the debtor's smaller parcel in proposing to deed it to her in full settlement of her demand.

But the undisputed evidence is that her demand amounts to about \$1.60 per sq. ft. of land held by her as security, whereas the demand of American Trust Company is less than 75c per sq. ft.; that the two parcels adjoin each other in the same block; that both are inside parcels; and that her parcel does not fit into the plan of reorganization proposed by the debtor.

If American Trust Company thought the plan was wrong in

this respect, it had the right to propose modification of the plan, but it did not, limiting itself to mere obstruction.

Besides, sec. 216 of the Act, 11 USC 616, subd. (2), expressly provides that a plan of reorganization "may deal with all or any part" of the debtor's property; and subd. (3) of that section expressly empowers the judge to authorize the debtor in possession to sell any property of the debtor on such terms and conditions as the judge may approve.

Moreover, the objection if valid, goes only to a minor detail of the plan; and if sustained, could and should be remedied by amendment of the plan, and is not sufficient ground for rejection of the plan.

2(d)

The debtor excepted (Exceptions 7 and 8) to the Special Master's finding, affirmed by the district court, that American Trust Company's 5th Objection to the plan is true, on the ground that said finding is not supported by evidence, is directly contrary to the only evidence in the record touching the matter, and is contrary to the express provisions of the plan. The Objection in question is that the plan contemplates that the assets of the debtor be used in a speculative venture for which there is no reasonable prospect of success.

At the outset, there is to this Objection the conclusive answer that out of the sale price of each of the proposed 23 dwellings to be erected on the property in question pursuant to the plan, American Trust Company is given an absolute preference to the extent of the pro rata of its new mortgage on the parcel occupied by the dwelling sold,—an amount equal to the exact total of principal of its loan and advances, and, according to

the testimony of its expert witnesses, substantially as much as it can get by a sale of the land in its present condition.

It is also to be noted that there is no testimony in the record to the effect that the plan involves a speculative venture, nor that it has no reasonable prospect of success.

To the contrary, is the testimony of Mr. Thomas, one of the expert witnesses called by American Trust Company, explaining the greater relative value of the adjoining Fillmore-Turk corner, as due to its being improved with stores and a hotel upstairs, though old (Rec., p. 120); and of Mr. Bufford, the debtor's president, stating the increase in sale price of the adjoining Steiner-Turk corner, when improved with a gas station (Rec., pp. 126 and 127).

This testimony is very persuasive that the property in question, if suitably improved, will sell readily for far more than American Trust Company's experts now value it at.

Mr. Bufford also gave testimony, wholly unquestioned, in support of the soundness, from every point of view, of the building program proposed in the plan of reorganization. (Rec., p. 128 to 132.)

He testified that lots improved as outlined in the plan, will have a land value of \$2,000, and, with improvements costing not to exceed \$7,500, will sell for about \$10,000 per lot.

He also testified that he was informed by the engineer's office in the City Hall that a 26-foot pavement for the proposed street was satisfactory.

He further testified: Across the street from the proposed development, there is a row of flats. Next door to it, there are two flats. To the east, from Fillmore to Webster, there are a number of apartment houses of various sizes. And there are

other residences in the vicinity, both on Eddy and Turk Streets. A modernization program is going on, as regards the flats across the street from the proposed development. In the last 6 months the flats immediately to the west of the property in question have been modernized. The demand for residential accommodations in the district is very good. There are very few vacancies in the neighborhood,—less than 10 per cent.

Thus the proposed plan is no more speculative in nature than the construction of any building in any thickly populated district, wherein there is a constant demand for all available buildings of the type proposed.

If this plan can be rejected on this ground, it means that no subdivider can successfully propose a plan of reorganization which involves a building program.

This very objection has been definitely overruled in several cases.

In *New Rochelle*, CCA 2, June 3, 1938, 77 Fed. 2d 881, it was argued that the plan there involved was unfair because "there should be some guaranty that by the end of 3 years the creditors would be paid without question." The court answered, p. 883, "Nothing in the statute requires such a guaranty in a plan of reorganization."

The 7th Circuit court, answering an objection that the plan there proposed was not feasible in that it was dependent for success upon future economic conditions, said: "What the property is, and what it has produced, is well known. What it will do in the future is, of course, problematical. Under existing conditions no one can say with assurance that the plan will succeed. The district court thought that immediate liquidation would be disastrous to all interests and that there was

reasonable ground for believing that the plan would succeed. We concur in that view.” 333 N. Michigan Ave., CCA 7, July 1, 1936, rh. dn. July 24, 1936, 84 Fed. 2d 936.

A district court very recently took the same view. In approving, over bondholders’ objections, a plan of reorganization of a small company, it pointed out, in answer to certain objections, that without the plan the bondholders’ investment was worth about 30 cents on each dollar invested; that under the stock and bond provisions of the plan, if their stock should be ultimately called, they would get 40 cents on the dollar, plus dividends from Jan. 1, 1943, until called. Central Forging, Dist. Ct. Pa., Apr. 15, 1941, 38 FS 18.

Far from the proposed plan of reorganization being a speculative venture without reasonable prospect of success, it assures American Trust Company of as much as its expert witnesses assert it can get out of the property in its present condition, affords reasonable basis for belief that it will realize all the remainder of its demand, and offers the debtor’s stockholders a reasonable opportunity to realize on their equity in the land.

It is clear from the cases cited, that to warrant approval of a plan, absolute certainty of success is not requisite.

Besides, it appears in the evidence that the debtor’s old dwelling-houses, such as they are, now on its property, are continuously occupied; that there is an unsatisfied demand for residential quarters in the neighborhood in question; and that the property in question, by reason of size and location, is peculiarly well suited for the development proposed by the plan of reorganization.

It is also to be noted: On the property in question as it now stands, there are no corner lots: it is all inside property: the

plan will have the additional advantage of creating 4 corner lots: this factor alone will add much value.

2(e)

The debtor also excepts to the Special Master's findings, affirmed by the district court, that the debtor is insolvent and that its obligations to American Trust Company far exceed the value of the security, on the ground that these findings deal with matters outside the issues in the case, and that the objections of American Trust Company to the plan of reorganization, based on these propositions, are without force or validity.

In *Dollar Dry Cleaning, Dist. Ct. Conn., June 21, 1940, 33 FS 861*, the court pointed out that the transcript of the hearing before the referee showed clearly that the referee's recommendation of liquidation was predicated upon the debtor's insolvency. The court held: "The question of insolvency was not directly in issue before the referee. Instead the true issue under Ch. X was whether or not the interests of the creditors and stockholders required an adjudication, or a dismissal instead."

The decisions in the 2nd Circuit demonstrate that insolvency is a false issue in reorganization proceedings. In *Central Funding, CCA 2, Feb. 11, 1935, 75 Fed. 2d 256*, the court overruled the objection to a plan of reorganization under sec. 77B that an insolvent debtor could not reorganize under that section. In *New Rochelle, CCA 2, June 3, 1935, 77 Fed. 2d 881*, the court overruled the contrary objection that a solvent company was not entitled to reorganize under sec. 77B.

With respect to farmer-debtors, the Supreme Court in *John Hancock Ins. Co. v. Bartels, Dec. 4, 1939, 308 U. S. 180, 184-185, 60 S. C. 221, 84 L. 176*, declared: "The plain purpose of sec. 75 was to afford relief to such debtors who found them-

selves in economic distress however severe", and affirmed the action of the 5th Circuit in directing a district court to reinstate a farmer-debtor's petition under sec. 75, which the district court had dismissed.

In another case, the Supreme Court reversed a district court's dismissal of an insolvent irrigation-district's plan of composition, stating, "As the bankruptcy power may be exerted to give effect to a plan for the composition of the debts of an insolvent debtor, we find no merit in appellant's objections under the 5th Amendment." *U. S. v. Bekins*, Apr. 25, 1938, 304 U. S. 27, 54, 58 S. C. 811, 82 L. 1137.

And, in reversing the confirmation by a district court of a plan of reorganization of a corporation with secured claims amounting to \$3,800,000 and total assets not exceeding \$900,000, in answer to the contention that if the district court was reversed, the stockholders would lose everything, the Supreme Court declared, "Failure to accept this plan does not force dismissal or liquidation . . . In this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted". *Case v. Los Angeles Lumber*, Nov. 6, 1939, 308 U. S. 106, 131-132, 60 S. C. 1, 84 L. 22.

Thus, a plan of reorganization may be worked out by a corporation, although hopelessly insolvent.

2(f)

The debtor also excepted (Exception 3) to the Special Master's finding, affirmed by the district court, that American Trust Company's objection to the plan, that it contemplates the creation of a prior encumbrance upon the property, is true, on the ground that this finding deals with a matter outside the

issues in the case, and that the objection to the plan, based on this finding, is without force or validity.

The prior encumbrance authorized by the plan, is the issuance of noninterest-bearing certificates of indebtedness to the amount of the actual value of labor and materials furnished to be used and actually used on the property in its development for residential purposes and the construction thereon of the proposed duplex dwellings; and the amount of this proposed prior encumbrance is to be no greater than the value thereby added to the security.

The creation of a prior encumbrance to secure these advances is in exact conformity with sec. 116(2) of the Act, 11 USC 516(2), which provides, "The judge may authorize certificates of indebtedness for cash, property, or other consideration, upon such terms and conditions and with such security and priority in payment over existing obligations, secured and unsecured, as in the particular case may be equitable."

That new money and property furnished, may equitably be given priority over old money is an age-old principle of admiralty law, also applicable in other fields of law, with which this court is familiar.

2(g)

The debtor's exceptions 9 and 10 attack the ruling of the Special Master, affirmed by the district court, that the only question before him was the value of the property in question at the time of his hearing, in its then present condition, and his refusal to consider its value were the plan of reorganization carried out.

The debtor's contention is that the relevant inquiry is the value of the property if the plan is carried out.

In *Reb Holding Co.*, Dist. Ct. Wis., Nov. 19, 1940, 35 FS 716, the court overruled a Special Master who took a view similar to that of the Special Master here. In rejecting the Master's report against a plan of reorganization, and upping the valuation the Master put on the property there involved, the court declared, p. 717: In determining valuation of property of the debtor in corporate reorganization proceedings, "no one valuation should be used exclusively in arriving at a fair valuation. By using the various methods, any inaccuracy which might be inherent in one method, can be eliminated. It is the purpose of Ch. X to conserve, if possible, the full value of the property for junior creditors and for the debtor, as well as for the creditors who might have priority."

Another district court, in upping the valuation placed upon Cuban bonds by a Special Master to the extent of \$3,873,635, after mentioning older ideas of value, said: "There is, however, a noticeable present tendency not to be bound by instant market prices, but to look into the future, to a proper extent, in appraising the value of property . . . This tendency should be especially applicable to valuations under sec. 77B. It is well settled that the words 'fair value' need not mean liquidating value, nor need they be regarded in law as equivalent to present realizable value . . . And especially is this true when one considers that the purpose of sec. 77B is to enable corporations in financial difficulties to readjust their indebtedness and continue in business without a forced liquidation of their assets." *Warren Bros. Co.*, Dist Ct. Mass., May 26, 1941, 39 FS 381, 384.

The Supreme Court has also had occasion to take a similar view of the problem. In reversing the confirmation by a district court of a plan of reorganization, and remanding the cause for further proceedings, it pointed out the necessity of seeking to value the enterprise in question by a capitalization of future earnings, and added, "Findings as to the earning capacity of an enterprise are essential to determination of the feasibility as well as the fairness of a plan of reorganization." *Consol. Rock Products v. Du Bois*, Mch. 3, 1941, 312 U. S. 510, 525, 61 S. C. 675, 85 L. 982.

It is evident that in passing upon a plan of reorganization the court must consider "going-concern" values and not "liquidation" value,—value in the event the plan is adopted, not value in the company's embarrassed condition.

It is obvious that the value of the present debtor's property in its present state, in part unoccupied and in part inadequately occupied, and in consequence returning insufficient revenues to cover carrying charges or give a return on the investment, is far less than that value would be, were the property subjected to a comprehensive plan of improvement, reasonably calculated to bring in an adequate return on a larger valuation.

There was testimony before the Special Master definitely showing that if the debtor's plan was carried out, the value of the property would be greatly enhanced: the Master erred in refusing to consider such testimony in arriving at value.

3(a)

Turning from the Objections to the plan of reorganization, none of which may properly be deemed of merit, and from errors of the district court in other respects, I urge affirmatively

that the plan complies with all statutory requirements, and with all court decisions, as to fairness and equitableness, and fully qualifies as a lawful and appropriate plan.

The plan renews American Trust Company's mortgage trust deed for the principal thereof and cash advances thereunder, amounting to \$29,755.31; and gives American Trust Company preferred capital stock of the debtor, with absolute priority, to the amount of other sums due it.

In *Case v. Los Angeles Lumber*, Nov. 6, 1939, 308 U. S. 106, 60 S. C. 1, 84 L. 22, wherein a plan was set aside as not fair and equitable, the debtor was a holding company; the bondholders' lien covered the capital stock owned by the debtor in all its subsidiaries; the bondholders' claims amount to \$3,800,000; assets did not exceed \$900,000, considerably over \$800,000 of which were subject to the bondholders' lien; the proposed plan gave the bondholders preferred stock with absolute priority in lieu of their bonds, but only in the amount of \$641,375, or 77 per cent of the value of the security, and turned the other 23 per cent of the security over to the stockholders.

Similarly in *Chapman Bros. v. Security-1st Bank*, CCA 9, Apr. 10, 1940, 111 Fed. 2d 86, where this court set aside a plan as not fair and equitable, it was objectionable for the same reason as the plan in *Case v. Los Angeles Lumber*: it required a secured creditor to share his inadequate security with an insolvent debtor.

The plan here, however, is free from these objections. It not only gives American Trust Company absolute priority to the full extent of its entire demand, but, through the preferred stock provisions of the plan, extends to it preferred participa-

tion in the general assets of the debtor, as well as in its security, if needful to the liquidation of its demand.

In *Consol. Rock Products v. Du Bois*, Mch. 3, 1941, 312 U. S. 510, 61 S. C. 675, 85 L. 982, wherein a plan was set aside, the debtor had intermingled the assets of 2 wholly owned subsidiaries with its own, and besides owed the subsidiaries large sums of moneys; and the court held that in the absence of findings as to the values of the respective interests of the 3 companies in the assets, and as to the state of accounts between them, a court was not in a position to determine the fairness and equitableness of a plan of reorganization as between the 2 sets of bondholders of the 2 subsidiaries and other interested parties.

In concluding its discussion, the court declared in the latter case, pp. 528 and 529 of 312 U. S.: "The absolute priority rule does not mean that bondholders cannot be given inferior grades of securities or even securities of the same grade as are received by junior interests. Requirements of feasibility of reorganization plans frequently necessitate it in the interests of simple and more conservative capital structures . . . While creditors may be given inferior grades of securities, their 'superior rights' must be recognized . . . Practical adjustments, rather than rigid formula, are necessary. The method of effecting full compensation for senior claimants will vary from case to case."

Intermediate the 2 Supreme Court decisions last considered, in a case of great magnitude, the Supreme Court denied certiorari from a decree of the 2nd Circuit, whereby a plan of reorganization conformable to the last quoted statement of the Supreme Court had been approved. The Court of Appeals

held that want of fairness and equitableness in the plan there before it could not be predicated upon issuance to creditors of prior preferred stock in lieu of bonds secured by a trust deed, and approved a plan so providing. *Radio-Keith-Orpheum, CCA* 2, July 18, 1939, 106 Fed. 2d 22, cert. dn. Jan. 2, 1940, *Cassel v. R-K-O and Stirn v. Atlas*, 308 U. S. 622, 60 S. C. 380, 84 L. 520, rh. dn. Feb. 5, 1940, 309 U. S. 694, 60 S. C. 512, 84 L. 1035.

The plan in this case goes beyond the requirements of *Radio-Keith-Orpheum*, last cited.

Indeed, it was recognized in *Kuehner v. Irving Trust*, Jan. 4, 1937, 299 U. S. 445, 451-452, 57 S. C. 298, 81 L. 340, that while a secured creditor's security cannot be diverted from its function of securing his demand, his demand may nevertheless be scaled down.

The court declared: "There is, as respects the exertion of the bankruptcy power, a significant difference between a property interest and a contract, since the Constitution does not forbid impairment of the obligation of the latter. The equitable distribution of the bankrupt's assets, or the equitable adjustment of creditors' claims in respect to those assets, by way of reorganization, may therefore be regulated by a bankruptcy law which impairs the obligation of the debtor's contracts. Indeed, every bankruptcy act avowedly works such impairment. While, therefore, the 5th Amendment forbids the destruction of a contract, it does not prohibit bankruptcy legislation affecting the creditor's remedy for its enforcement against the debtor's assets, or the measure of the creditor's participation therein, if the statutory provisions are consonant with a fair, reasonable and equitable distribution of those assets."

District courts, accordingly, have approved plans scaling down secured creditors' demands. *Central Forging*, Dist. Ct. Pa., Apr. 15, 1941, 38 FS 18.

The plan is not only completely within the limits of fairness and equitableness as defined in the decisions, but every provision of the plan is specifically authorized by express provisions of Ch. X.

Sec. 116(2) of the Act, 11 USC 516(2), expressly provides that the judge may authorize certificates of indebtedness for property, with such security and priority in payment over existing obligations, secured or unsecured, as in the particular case may be equitable. The plan so provides, with proper and adequate safeguards to protect the interests of all concerned.

The other provisions of the plan are exactly within the authorization of subsection 216(10), 11 USC 616(10), of the Act, which provides that a plan may include: The retention by the debtor of all or any part of its property; the sale of all or any part of its property, subject to or free from any lien, at not less than a fair upset price, and the distribution of all or any assets or the proceeds of the sale to those having an interest therein; the curing or waiver of defaults; the extension of maturity dates; changes in interest rates; the amendment of the debtor's charter.

3(b)

The plan is feasible, proposing a workable plan for the utilization of the debtor's property, in the course of the execution of which it is reasonable to expect that sufficient returns will be realized to liquidate American Trust Company's entire demand and also give some return, over and above that, to the debtor's stockholders.

There is nothing for which there is a more constant demand in any great city than for good dwellings. Every thickly settled neighborhood has a type suited thereto; and where, as in the neighborhood here in question, existing dwellings are almost fully occupied, there is evident room for new construction of a proper type. The building industry is so far standardized that costs of construction, dependent on type and elegance, can be accurately estimated in advance, eliminating speculative factors. No enterprise, more substantial, nor with greater certainty of success, could be found than the building program proposed in the plan; nor one that promotes a more fundamental policy of the national government.

The evidence on this point, as well as applicable decisions, have already been reviewed quite fully in section 2(d) of the argument of this brief, dealing with the objection that the plan calls for a speculative venture.

It cannot be doubted that the plan is feasible: yet on this fundamental question neither the Special Master, nor the district court, made any findings. This alone is reversible error.

4

It was an abuse of discretion, and hence reversible error, for the district court to refuse to amend its decree disapproving the debtor's plan of reorganization and dismissing the proceedings, so as to grant the debtor leave to amend the plan or to present an alternative plan calculated to meet and remove objections.

At the time the decree was issued, only one plan had been proposed, and no opportunity had been given, at any stage of the proceedings, to amend the same.

By the terms of the reference to the Special Master, he was limited to a consideration of the issues raised by the objections of American Trust Company to the plan, and by those objection no question respecting the amendment of the plan was raised, but its entire rejection was demanded.

The Special Master had no power to consider any matter outside the terms of the order of reference: thus the debtor could not move him for leave to amend.

Nor was it desirable or appropriate for the debtor to move the district court for leave to amend its plan before it had passed on the debtor's exceptions to the Certificate and Report of the Special Master. And as the district court passed upon those exceptions as part of its decree, it is evident that the debtor was not, at any stage of the proceedings, afforded any opportunity to amend its plan.

The analogies afforded by the Rules of Civil Procedure indicate that it was reversible error for the district court to fail to grant the debtor ~~the~~ leave in question. For sec. 15(a) as to amendments to pleadings, after stating that after a responsive pleading or the lapse of 20 days, a party may amend a pleading only by leave of court or written consent of the adverse party, adds, "Leave shall be freely given where justice so requires."

It is evident that in this case "justice so requires"; for if the leave is not granted the purposes of Ch. X will be defeated insofar as the debtor is concerned.

In introducing the Act into the House, Representative Chandler said: "The theory now is to conserve rather than liquidate the estate, give the debtor a chance to work out his financial difficulties and not destroy his business . . . It means that when financial evil days come upon one, he may seek the aid

of the bankruptcy court of the United States, and by this method may keep his creditors at bay until he has time to regain his financial equilibrium." Cong. Rec. House, Aug. 10, 1937, 75th Cong. 1st Sess., p. 8649.

In introducing the Act into the Senate after passage by the House, Senator O'Mahoney said: "If I were to describe this bill in a single line, it would be 'a measure fashioned to promote rehabilitation of business rather than liquidation.' " Cong. Rec. Sen., June 10, 1938, 75th Cong. 3rd Sess. p. 8679.

In similar vein, in one of the earliest cases to come before a Court of Appeals, respecting corporate reorganizations, the 2nd Circuit said: "The apparent purpose of sec. 77B of the Bankruptcy Act, 11 USC 207, which provides for proceedings in the reorganization of a corporation and its subsidiaries, is to avoid immediate liquidation of the properties involved, and to rehabilitate rather than liquidate." *Greyling Realty Corp.*, CCA 2, Jan. 7, 1935, 74 Fed. 2d 734, 736, cert. dn. Apr. 1, 1935. *Troutman v. Compton*, 294 U. S. 725, 55 S. C. 639, 79 L 1256.

Similarly the 8th Circuit, in affirming an order refusing bondholders the right to foreclose on a hotel, declared that the evidence conclusively showed that at the time of the district court's order there was no market whatever for the hotel, and added: "So it is not difficult to see that if sold now, no one except appellant could be or would be a bidder at such sale, and an unnecessary sacrifice of value would occur, with the result that the deficiency to be allowed in favor of appellant as a general creditor would be shockingly unjust to the estate and to other unsecured creditors, as also to the holders of bonds secured by the second mortgage." *Central States Life v. Koplar Co.*, CCA 8, Dec. 17, 1935, rh. dn. Feb. 5, 1936, 80 Fed. 2d 754, 760.

The Supreme Court has emphasized that courts must construe liberally the provisions of the Act respecting reorganizations with a view to effectuating their purpose.

In rejecting a construction of Ch. X which would bar a landlord's right to prove a contingent claim in a reorganization proceeding, it declared: "Such a construction would ill accord with the remedial purposes of the Act, which demand a liberal construction in favor of the claimants for whom relief is intended." *City Bank v. Irving Trust*, Jan. 4, 1937, 299 U. S. 433, 444, 57 S. C. 292, 81 L. 324.

In sustaining the provisions of the 2nd Frazier-Lemke Act for extension of the time of redemption from sales in pursuance of mortgage contracts, it said: "The development of bankruptcy legislation has been towards relieving the honest debtor from oppressive indebtedness and permitting him to start afresh. By the Act of March 3, 1933, the Congress deliberately undertook the rehabilitation of the debtor as well as his discharge from indebtedness . . . This legislation for rehabilitation has been upheld as within the subject of bankruptcies." *Wright v. Union Central Life*, May 31, 1938, 304 U. S. 502, 514, 58 S. C. 1025, 82 L. 1490.

In affirming the action of the 5th Circuit in directing a district court to reinstate a farmer's petition under sec. 75 of the Act, 11 USC 203, which the district court had dismissed, it said: "The subsections of sec. 75 which regulate the procedure in relation to the effort of a farmer-debtor to obtain a composition or extension, contain no provision for a dismissal because of the absence of reasonable probability of the financial rehabilitation of the debtor. Nor is there anything in these subsections which warrants the imputation of lack of good faith to a

farmer-debtor because of that plight. The plain purpose of sec. 75 was to afford relief to such debtors who found themselves in economic distress however severe, by giving them a chance to seek an agreement with their creditors (subsections (a) to (r)), and, failing this, to ask for other relief afforded by section (s).” *John Hancock Ins. Co. v. Bartels*, Dec. 4, 1939, 308 U. S. 180, 184-185, 60 S. C. 221, 84 L. 176.

What is more, the Supreme Court views the right to present an amended or different plan as one that still exists after reversal of an order of a district court confirming an earlier plan. For in reversing a previous confirmation of a plan, the Supreme Court, in answer to the suggestion that were the district court reversed the stockholders would lose everything, declared that the right to present an amended or different plan would still exist after the reversal. It said: “Failure to accept this plan does not force dismissal or liquidation. Sec. 77B(c) (8), 11 USC 207(c) (8), gives explicit powers where ‘a plan of reorganization is not proposed or accepted within such reasonable time as the judge may fix’ either to ‘extend such period’ or to ‘dismiss the proceeding’, or, with exceptions not relevant here, to cause liquidation, such choice to be made ‘as the interests of the creditors and stockholders may equitably require’. Accordingly, dismissal has not infrequently been properly denied. *Bush Terminals*, CCA 2, July 6, 1936, 84 Fed. 2d 984. And in this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted nor that all reasonable time for proposal of such alternative plan has expired.” *Case v. Los Angeles Lumber*, Nov. 6, 1939, 308 U. S. 106, 131-132, 60 S. C. 1, 84 L. 22. (The provision of sec. 77B

referred to and quoted in this decision is now incorporated into sec. 236 of the Act, 11 USC 636.)

In *Bush Terminals*, cited with approval by the Supreme Court in the foregoing quotation from *Case v. Los Angeles Lumber*, the 2nd Circuit, in reversing at the instance of certain creditors and stockholders a dismissal of a reorganization proceeding at the debtor's request, pointed out that it was plain the debtor could not meet his obligations in the usual course of business were certain disputed claims found valid, and instructed the district court to adjudicate those claims; thereupon consider the proposed plan of reorganization as well as any amended or further plan presented within such time as the court might deem reasonable; then if none of them were adopted, dispose of the property of the debtor or the proceeds thereof in such way as will adequately protect all creditors; or, in the event creditors were satisfied, turn over the property to the debtor. *Bush Terminals*, CCA 2, July 6, 1936, 84 Fed. 2d 984.

Indeed, with respect to plans of reorganization, the 7th Circuit is of opinion that a district court is charged with the affirmative duty of taking the initiative needful to secure an equitable and feasible plan. In a proceeding by an individual, under sec. 74 of the Act, 11 USC 202, for a composition or extension of time, the 7th Court, in affirming the action of a district court refusing to vacate an order restraining the foreclosure of a mortgage, the mortgagee being the bankrupt's sole creditor, said: "We may add, success under this Act will not be assured, unless the court recognizes that its duties are primarily administrative. It must act as the head of the administrative branch of an enterprise. It cannot sit idly by and act

on plans submitted. It must originate, if necessary, and in many cases use all the forces at its command to bring about cooperation between conflicting interests. It may have to remove officers by it appointed if plans and recommendations are not presented within a reasonable time." M. M. Sterba, CCA 7, Jan. 5, 1935, 74 Fed. 2d 413.

It is evident that the district court's refusal to grant the debtor leave to amend the plan or to present an alternative plan was reversible error, and that its dismissal of the proceedings was premature, especially in view of the debtor's expressed willingness in its affidavit in support of its motion for said leave to propose and accept a plan substantially identical in form with the farmer's legislative plan of reorganization under the 2nd Frazier-Lemke Act, approved as against all objections in *Wright v. Vinton Branch*, Mch. 29, 1937, 300 U. S. 440, 57 S. C. 556, 81 L. 736.

CONCLUSION

It thus appears:

1st. That none of the objections to the proposed plan of reorganization is sound;

2nd. That it meets all requirements as to fairness and equitableness and feasibility;

3rd. That Ch. X is entitled Reorganizations; its purpose is to promote them; the policy of the Act is that all parties shall co-operate in formulating them and making them effective; it is the duty of a district court to act affirmatively to that end;

4th. That the district court erred not only in disapproving the proposed plan, but, beyond that, in refusing leave to amend the same or to present a different plan, thus in effect denying

the debtor the relief contemplated by Ch. X, and so far as it is concerned, erasing the Act from the statute books.

It follows that the decree and order appealed from should be reversed, with instructions to the district court to take proceedings in the case not inconsistent with the decision of this court.

San Francisco, Calif., January 20, 1942.

CHARLES M. BUFFORD,
Attorney for appellant.

No. 9985

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SAN FRANCISCO LAUNDRY ASSOCIATION
(a corporation),

Appellant,

vs.

AMERICAN TRUST COMPANY,

Appellee.

BRIEF FOR APPELLEE.

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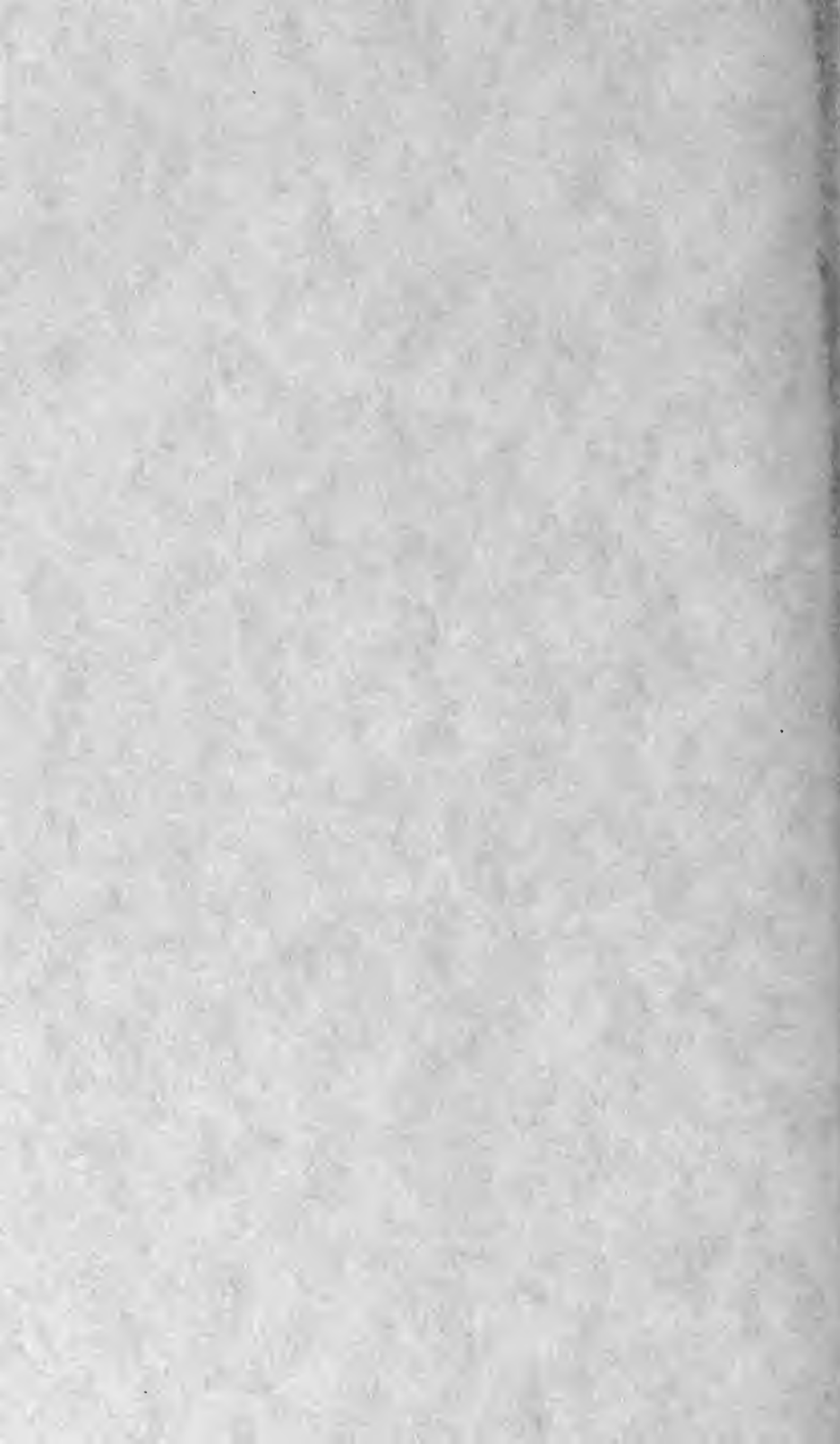
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Subject Index

	Page
Statement of Facts	1
Argument	9
The court had no alternative except to dismiss the proceedings	9
Appellee's answer was not filed too late.....	12
The master's certificate and report was not defective.....	15
The finding of insolvency is sustained by the evidence.....	15
The plan scales down the indebtedness to American Trust Company, unjustly discriminates against appellee, contemplates a speculative venture which has no reasonable prospect of success and provides for the creation of a prior indebtedness	16
The ninth and tenth specifications of error are untenable...	17
The finding of insolvency was within the issues.....	22
The plan was not fair, equitable or feasible.....	23
The court did not err in refusing leave to submit an alternative plan	24

Table of Authorities Cited

Cases	Pages
Baird v. Smith, 216 Cal. 408.....	13
Case v. Los Angeles Lumber Products Company, 308 U. S. 106	10, 15, 22, 23, 24
Chapman Bros. Co. v. Security First National Bank of Los Angeles, 111 Fed. (2d) 86.....	10
620 Church St. Building Corporation, In re, 299 U. S. 24..	23
Oakland Hotel Company v. Crocker First National Bank (C.C.A. 9), 85 Fed. (2d) 959.....	14, 15, 23, 24
Willoughby, In re, 95 Fed. (2d) 932.....	10

Statutes

Bankruptcy Act:	
Chapter X	10, 11, 22
Section 145	10
Section 146	10
Section 236	15, 24
Section 238	14

Text

Remington on Bankruptcy, Section 3803.....	10, 13, 16
--	------------

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IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SAN FRANCISCO LAUNDRY ASSOCIATION
(a corporation),

Appellant,

vs.

AMERICAN TRUST COMPANY,

Appellee.

BRIEF FOR APPELLEE.

STATEMENT OF FACTS.

The appellant, San Francisco Laundry Association, is a California corporation, organized for the purpose of carrying on and conducting "in all its branches the business of a laundry in the City and County of San Francisco, and such other business as may be connected therewith or necessary for the prosecution thereof". (R. 47.) Until 1936 it carried on a general laundry business. Under date of May 29, 1936, it transferred and assigned to A. L. May all of its assets other than real property in trust for the benefit of its unsecured creditors. (R. 4 and 48.) The trustee operated the business until November 12, 1938, at which time the trustee sold all of the appellant's laundry equipment and other assets (except real

estate), and applied the proceeds to the payment of the appellant's unsecured creditors. (R. 38.) The building in which the laundry had previously been conducted was wrecked and converted into a parking lot. Since the sale of the personal property by the trustee, the appellant has not conducted any business other than the collection of rents from its real estate and the sale and liquidation of its assets. (R. 38.) Appellant has no unsecured creditors and but two secured creditors, the appellee American Trust Company and Florence Brownfield. (R. 9, 10, 38 and 70.) The indebtedness owing to the American Trust Company exceeds the sum of \$39,000.00 (R. 32, 61, 71 and 123 and is secured by a deed of trust on all but a small portion of the appellant's real property. (R. 10, 71.) The indebtedness to Florence Brownfield according to the appellant's schedules amounts to \$3500.00 (R. 11), and is secured by a deed of trust on the remainder of the appellant's real estate which appellant in its schedules and in the plan proposed by it conceded to have a value less than the indebtedness. (R. 11 and 70.) According to the testimony of the witnesses produced by the American Trust Company (R. 28 and 30), and the appraisal made by the appraiser appointed by the court (R. 50), the value of the real estate subject to the deed of trust securing the indebtedness owing to the American Trust Company does not exceed \$30,000.00, and the value of the property subject to the deed of trust securing the indebtedness to Florence Brownfield does not exceed the sum of \$3200.00 (R. 50.)

Aside from the real estate subject to the two deeds of trust mentioned, the appellant has no assets excepting receivables in the amount of \$985.00, contracts of conditional sale on which there is owing not to exceed \$1612.00 and certain office furniture and fixtures having a value of less than \$300.00. (See Appellant's Schedules at pages 11 and 12 of Record and the Proposed Plan of Reorganization at page 61 of the Record.)

Nothing has been paid on the indebtedness owing to the American Trust Company since October 1939, with the exception of one payment of \$500.00, which was made in January, 1940. (R. 123.) The appellant has for several years failed to pay the taxes on the real estate hypothecated to American Trust Company (R. 123), but has nevertheless collected rents aggregating approximately \$200.00 per month, the greater part of which has been paid to the president of the corporation, who has received a salary of \$150.00 per month since before the commencement of this proceeding. (R. 37 and 39.)

The appellant being in default in the payment of the obligation owing to it, the American Trust Company, recorded a notice of default and proceeded to have the property covered by the deed of trust advertised for sale. Thereupon, the appellant filed its petition for corporate reorganization in this proceeding and obtained an order restraining the American Trust Company and the trustee under the deed of trust from proceeding to sell the property. The American Trust Company filed an answer herein con-

troverting certain allegations contained in the appellant's petition and particularly controverting the allegations that the petition was filed in good faith, and that appellant's assets exceeded its liabilities. (R. 20 et seq.) The issues raised by the answer were referred to Hon. Burton J. Wyman for hearing and report. (R. 27.)

Before the Special Master rendered his report thereon, the appellant filed herein a proposed plan of reorganization. (R. 60 et seq.) Briefly summarized, the plan provided that the property subject to the deed of trust in favor of Florence Brownfield should be conveyed to her in satisfaction of the indebtedness thereby secured; that a street fifty feet in width would be cut through the center of the property subject to the American Trust Company's deed of trust and donated to the City and County of San Francisco; that the remainder of the property should be subdivided into lots; that the cost of paving the street and subdividing the property and erecting dwelling houses thereon should be paid by the issuance of appellant's certificates which would take priority over the American Trust Company's deed of trust; that the indebtedness due the American Trust Company be reduced from an amount in excess of \$39,000.00 to approximately \$30,000.00, and the interest rate thereon reduced from six to four per cent per annum; that all of the balance of the indebtedness due the appellee should be canceled by the issuance of preferred stock; that such preferred stock should have an absolute liquidation preference *but should not be preferred*

either as to dividends or voting, each share of common stock and each share of preferred being entitled to the same vote and dividend; that dwelling houses should then be constructed on the lots and that the American Trust Company should take its chance on recovering anything on the indebtedness owing to it and the preferred stock to be issued to it on the appellant's being able to sell the houses at a profit; that in the meanwhile the president and present counsel of appellant should be paid a salary of \$150.00 per month.

Promptly upon the filing of the plan, the American Trust Company filed objections thereto on the ground that it was unfair and inequitable in each of the following particulars (R. 77 and 78):

1. That the appellant was insolvent, and said plan contemplated the realization by the appellant and its stockholders and officers of money, assets, and property at the expense of the creditor.

2. That the plan contemplated the creation of a prior encumbrance upon the property hypothecated to the creditor, notwithstanding the fact that the obligations due from the appellant to American Trust Company far exceeded the value of that property.

3. That the plan discriminated unjustly in favor of Florence B. Brownfield and against American Trust Company, in that it contemplated that the property hypothecated to Mrs. Brownfield should be conveyed to her in satisfaction of the obligations owing to her, but contemplated that the property hypothecated to American Trust Company should be retained by the appellant.

4. That the plan provided for the scaling down of the indebtedness owing to American Trust Company.

5. That the plan contemplated that the assets of the appellant should be used in a speculative venture for which there is no reasonable prospect of success.

It prayed that the plan be disapproved and the proceedings dismissed or the appellant adjudicated a bankrupt.

Thereafter, an order was made that the issues raised by the objections to the plan be referred to Burton J. Wyman as Special Master, to take testimony and report to the court. In pursuance of this order of reference, the Special Master held a hearing on the objections, and the matter was submitted on briefs.

On July 24, 1941, the Special Master submitted his certificate and report on the issues raised by the answer of the American Trust Company and the objections of the American Trust Company to the proposed plan of reorganization. (R. 1 to 100, inclusive.) The Special Master concluded his report as follows:

“Although there have been hearings on two different matters in connection with this debtor proceeding, as is shown in detail by the record herein, I am of the opinion that the court can best deal with the pending questions on the basis of American Trust Company’s prayer at the end of its objections ‘that said plan of reorganization be disapproved and that the proceedings be dismissed or Debtor adjudicated a bankrupt.’

Proceeding on the theory just stated, I find from the record that each and all of said objections are true, and I therefore conclude, as matter of law, that said objections are sufficient upon which to base an order disapproving the proposed plan of reorganization and dismissing the debtor's proceeding, or an order adjudicating said debtor a bankrupt.

I therefore respectfully recommend that the court make one or the other of the aforesaid prayed for orders." (R. 97-98.)

The appellant filed exceptions to the certificate and report of the Special Master. (R. 100 to 102, inclusive.)

On September 12, 1941, the court made an order affirming the Special Master's certificate, overruling the appellant's exceptions thereto, disapproving the plan of reorganization and dismissing the proceedings. (R. 103 and 104.)

On October 9, 1941, the appellant filed a motion with the court requesting leave within such time as the court might prescribe to amend its plan of reorganization or to submit an alternative plan. (R. 104.) In support of this motion the appellant submitted an affidavit of Charles M. Bufford, the president, principal stockholder and present counsel for appellant, to the effect that if leave were granted by the court the debtor would propose a plan containing the following provisions:

"Extension of maturity of the mortgage trust deeds held by the debtor's two creditors until

one year after the President shall proclaim the end of the present National Emergency, subject to an earlier sale of the property subject to either trust deed, or any part thereof, by mutual consent of the parties thereto; in the meantime one-half of the gross income of the property subject to each trust deed to go to the holders thereof, such holders to pay the taxes, the other half to go to the debtor, the debtor to be responsible for the maintenance and upkeep; interest to be reduced and penalties set aside; the court to reserve jurisdiction of the case for the purpose of authorizing improvements on any of the property in the event the same became desirable and issuing certificates of indebtedness in payment, if hereafter found proper in the sound discretion of the court;” (R. 107, 108.)

On October 22, 1941, the court made the following order:

“The motion to amend order entered September 12, 1941 having been submitted and fully considered, the Court finds that upon the facts as presented to the Court and upon the Report of the Special Master (heretofore approved), no plan could be proposed which would be acceptable under the provisions of the Bankruptcy Act, and, therefore, It is Ordered that the said motion to amend order of September 12, 1941 be and the same is hereby denied.” (R. 109.)

ARGUMENT.**THE COURT HAD NO ALTERNATIVE EXCEPT TO DISMISS
THE PROCEEDINGS.**

This proceeding involves but one disputed issue of fact, namely, the value of the property subject to the deed of trust in favor of American Trust Company. All other facts were admitted. That appellant's indebtedness owing to American Trust Company amounted to more than \$39,364.28, and its indebtedness to Mrs. Brownfield to more than \$3517.17 was also conceded by the appellant. (R. 61.) That the appellant had no unsecured creditor and but two secured creditors, American Trust Company and Florence Brownfield, was likewise conceded by appellant. (R. 70 and 72.) That the appellant owned no real estate except the property subject to the deed of trust in favor of American Trust Company and the property subject to the deed of trust of Florence Brownfield was also admitted by the appellant in its schedules. (R. 10 and 11.) That the value of the property subject to the Brownfield deed of trust was less than the obligations secured by that deed of trust was admitted by appellant both in its schedules and in the proposed plan of reorganization. (R. 11 and 70.) That the value of all the appellant's personal property, including cash, contracts, receivables, and furniture and fixtures did not exceed \$2976.43 was also admitted by the appellant. (R. 69.) The one disputed issue of fact, namely, the value of the property subject to the deed of trust in favor of the American Trust Company was decided adversely to the appellant by the Special Master. By his finding that appellant was insolvent

(R. 77 and 98), the Special Master found that the value of the property subject to the American Trust Company's deed of trust was less than the obligations secured by the deed of trust. This finding was supported by the testimony of two witnesses (R. 28, 30, and 50), and by the appraisement of an appraiser appointed by the court, and having been approved by the District Court cannot be disturbed on appeal. Remington on Bankruptcy, Sec. 3803 and cases cited. *In re Willoughby*, 95 Fed. (2d) 932.

The one and only question presented on this appeal is, therefore, one of law,—whether it was “unreasonable to expect” that a plan of reorganization could be effected. For if it was unreasonable to expect that a plan of reorganization could be effected, appellant's petition for corporate reorganization was not filed in good faith (Bankruptcy Act, Sec. 146), and the court would have no other alternative than to dismiss the proceedings. (Bankruptcy Act, Sec. 14⁶~~5~~.) That it was unreasonable to expect that a plan of reorganization could be effected is, it is submitted, so clear as not to require argument. The only plan which could be proposed would be one that required the creditors to share their inadequate security with the insolvent debtor. Such a plan is not fair or equitable and cannot be effected under Chapter X of the Bankruptcy Act. This was expressly decided by the United States Supreme Court in *Case v. Los Angeles Lumber Products Company*, 308 U. S. 106, and this Court in *Chapman Bros. Co. v. Security First National Bank of Los Angeles*, 111 Fed. (2d) 86. In fact, the present

case can scarcely be distinguished from the case last cited. In that case a petition for reorganization was filed by a debtor under Chapter X. According to the petition it had assets of \$3,095,802.65, and a net worth of \$789,880.15. Of the assets, it was alleged that that \$3,058,350.00 represented the value of real estate covered by various deeds of trust given as security for obligations amounting to \$2,139,338.03. The Security First National Bank of Los Angeles filed an answer alleging that it held obligations of the appellant aggregating \$1,666,270.79, secured by various deeds of trust upon eighteen parcels of real property, and that the reasonable market value of said parcels did not exceed \$997,000.00. The answer further alleged that the reasonable market value of the real property owned by the debtor did not exceed the sum of \$1,262,736.00 instead of \$3,058,350.00 as alleged by the debtor. The trial court found that the indebtedness of the debtor corporation exceeded its assets by over a million dollars and that the debtor was hopelessly insolvent. Upon these findings the court concluded that the appellant's petition was not made in good faith; that it was unreasonable for the debtor corporation to expect that any plan of reorganization could be effected. The court dismissed the petition. Thereupon, an appeal was taken in the Circuit Court of Appeals for the Ninth Circuit. In affirming the order of the district court dismissing the petition, the Circuit Court of Appeals said:

“If the findings of the trial court are sustained by the evidence it is clear that the proposed plan of reorganization is lacking in good faith under

the express definition thereof contained in the Chandler Act, Sec. 146, 11 U.S.C.A. Sec. 546, which provides that 'a petition shall be deemed not to have been filed in good faith if * * *

(3) It is unreasonable to expect that a plan of reorganization can be effected.'

Such a lack of good faith requires a dismissal of the petition.

(1, 2) It is unnecessary to elaborate this question of 'good faith' in a petition for reorganization, as it has been so recently considered by this court (*Provident Mt. Life Ins. Co. v. University Ev. L. Church*, 9 Cir. 90 F. 2d 992) and by the Supreme Court. *Tennessee Pub. Co. v. American Natl. Bk.*, 299 U. S. 18, 57 S. Ct. 85, 81 L. Ed. 13, and *Case v. Los Angeles Lbr. Prod. Co., Ltd.*, 308 U.S. 106, 109, 60 S. Ct. 1, 84 L. Ed. The case last cited is directly applicable to the facts of this case, for it was there held that any plan which required a secured creditor to share his inadequate security with an insolvent debtor was unfair and inequitable within the meaning of the Bankruptcy Act. Sec. 77B, sub. f, 11 U.S.C.A. Sec. 207, sub f."

In view of these decisions, the court had no alternative except to dismiss the proceedings.

APPELLEE'S ANSWER WAS NOT FILED TOO LATE.

Appellant argues that the answer of American Trust Company to the petition for corporate reorganization was filed too late, and the allegations of the petition, showing that the debtor is not insolvent

in the absolute sense, must be deemed admitted for all the purposes of the case.

In presenting this argument, appellant is grasping at a straw.

The court originally set April 7, 1941, as the date for hearing under Section 161 of the Bankruptcy Act. The American Trust Company filed its answer on April 14, 1941. On that day the court made a minute order, and on April 16, 1941, a formal engrossment thereof referring the issues raised by the answer to the Special Master. The Special Master held hearings thereon which were attended by counsel for appellant. Every one concerned, the court, the Special Master, and the debtor, treated the answer as having been timely filed. No default was entered, and no motion to strike the answer was made. In fact, the debtor at no time raised the point that the answer was not seasonably filed until its brief was filed herein. It is well settled that the failure to have a default entered against a party required to file a pleading operates as an implied extension of time to such person within which to file his pleading. (*Baird v. Smith*, 216 Cal. 408.) It is equally well settled that a point or argument such as made by appellant cannot be raised for the first time on appeal. (Remington on Bankruptcy, Sec. 3808.)

Appellant is, moreover, scarcely in a position to raise the point. According to the record, the time within which appellant had to propose a plan of reorganization expired on April 29, 1941. (R. 27 and 28.) The plan was not filed until May 31, 1941. (R.

60, et seq.) Section 238⁶ of the Bankruptcy Act provides that when a plan is not filed within the time prescribed by the court, the court may dismiss the proceedings. Whether it should or not is a matter of discretion with the exercise of which this court will not interfere. (*Oakland Hotel Company v. Crocker First National Bank* (C.C.A. 9), 85 Fed. (2d) 959.) So far as the record is concerned, the appellant has no cause for complaint in respect to the dismissal of the proceedings.

In fairness to the court, however, although it does not appear in the record, the hearing under Sec. 161 was continued, and appellee's time to file its answer was extended from April 7, 1941, to April 14, 1941, by agreement between Mr. Robert B. Gaylord, Jr., who represented the debtor at the time and who withdrew from this case when the present appeal was filed, and the appellant's time for filing its proposed plan was extended by court order to a date after May 31, 1941. The act of appellant's learned counsel in urging that the answer was not seasonably filed can only be justified by his undoubted ignorance of the above-mentioned agreement and his excusable and very human desire to continue for a few more years the income of \$150.00 a month which he has heretofore enjoyed at the expense of the nonpayment not only of anything on the indebtedness due the American Trust Company but also taxes on the property securing that indebtedness.

**THE MASTER'S CERTIFICATE AND REPORT WAS NOT
DEFECTIVE.**

Appellant urges next that the Master's report was defective in not making findings on the issues raised by the answer. The point is not well taken. It is well settled that no findings are required in respect to facts not in dispute. Here the only fact in dispute was whether appellant was insolvent. As to that fact the Master found that the appellant was insolvent. (R. 77 and 98.)

Furthermore, the question is really moot. Section 236 of the Bankruptcy Act provides that when a plan is not approved the court may dismiss the proceedings. Whether the court should or not is largely a matter within the District Court's discretion with which this court will not interfere in the absence of a clear abuse thereof. (*Oakland Hotel Company v. Crocker First National Bank*, 85 Fed. (2d) 959.) Here the plan was disapproved and certainly it cannot be said that there was any abuse of discretion, particularly in view of the fact that no plan satisfying the requirements of *Case v. Los Angeles Lumber Products Co.*, 308 U. S. 106, could be effected.

**THE FINDING OF INSOLVENCY IS SUSTAINED BY THE
EVIDENCE.**

The appellant further argues that the finding of insolvency is not sustained by the evidence. The debtor conceded that its liabilities amounted to \$43,001.45 (R. 61); that the value of its assets exclusive of real

estate was \$2976.43 (R. 61); and that the property covered by the deed of trust to Florence Brownfield was \$2500.00. (R. 9, cf. R. 70.) Two witnesses (R. 28 and 30) and the court's own appraiser (R. 50) fixed the value of the debtor's remaining real estate at \$30,000.00. Certainly on this showing the debtor was insolvent. It is true that appellant's president, principal stockholder and present counsel testified that the real property last mentioned had a greater value, but his testimony merely created a conflict in the evidence. The Special Master's finding being supported by some evidence and having been approved by the District Court will not be disturbed on appeal. Remington on Bankruptcy, Sec. 3803.

THE PLAN SCALES DOWN THE INDEBTEDNESS TO AMERICAN TRUST COMPANY, UNJUSTLY DISCRIMINATES AGAINST APPELLEE, CONTEMPLATES A SPECULATIVE VENTURE WHICH HAS NO REASONABLE PROSPECT OF SUCCESS AND PROVIDES FOR THE CREATION OF A PRIOR INDEBTEDNESS.

It is apparent from the plan itself that it contemplates the scaling down of the indebtedness owing to the American Trust Company. The indebtedness amounting to \$39,364.28 is to be reduced to something below \$30,000.00, and the interest rate from 4% to 6% per annum. The balance of the indebtedness owing the American Trust Company for accrued interest is to be satisfied by the issuance of preferred stock (preferred only as to liquidation), which in view of the fact that the property is worth no more than \$30,000.00 will be absolutely worthless. That the

venture upon which the appellant's assets are to be used according to the plan is a speculative one is self-evident. There is no assurance that the dwellings to be erected on the property will sell for an amount sufficient to cover their cost and the encumbrances thereon.

As for the Special Master's findings that the plan presents no reasonable prospect of success, we submit that they are amply supported by the evidence quoted at length in the Special Master's certificate. It is true that Mr. Bufford, the president of appellant and owner of a majority of its stock, testified that there was a reasonable prospect of success and that the value of the property subject to the deed of trust was in excess of the amount of the indebtedness. It should be borne in mind, however, that Mr. Bufford is the one who will be primarily interested in the matter and that his testimony must, therefore, be regarded as colored by interest. On the other hand, the expert witnesses produced by the American Trust Company testified to the very contrary. The Special Master heard the evidence, and we submit that his findings are entitled to respect.

**THE NINTH AND TENTH SPECIFICATIONS OF ERROR
ARE UNTENABLE.**

In its brief appellant states:

“The debtor's exceptions 9 and 10 attack the ruling of the Special Master, affirmed by the district court, that the only question before him was the value of the property in question at the time

of his hearing, in its then present condition, and his refusal to consider its value were the plan of reorganization carried out.

The debtor's contention is that the relevant inquiry is the value of the property if the plan is carried out." (App. Brief, 31 and 32.)

The conclusive answer to this argument is that the Special Master did not rule that the only question before him was the value of the property at the time of the hearing in its then condition and that there is nothing in the record to show that he failed or to consider evidence as to what the value of the property would be if the plan were carried out. What transpired was this: At the hearing on the plan appellee offered in evidence the evidence that was introduced at the hearing on the issues raised by the answer. Appellant's counsel stipulated that it might be admitted, subject to the objection, the testimony as to the present value of the property in its existing condition was immaterial. (R. 85.) Counsel for appellee then stated in effect that as the venture contemplated by the plan was purely speculative and the primary question was whether the creditors alone were entitled to vote on the plan, only evidence as to the present value was material. The following colloquy then took place between the Special Master and counsel for appellant:

"The Master. I think so, Mr. Gaylord; otherwise you are speculating on what maybe will happen in the future.

Mr. Gaylord. Of course, that is necessarily true of any reorganization, is it not, your Honor,

whether the business can be operated at a profit or not? Which comes back to the same thing: whether its product, whatever it may be, can be sold at a profit.

The Master. That is true, but so far as fixed assets are concerned, you have to take them at the present value.

Mr. Gaylord. I would like to submit authorities on that point. But I have no objection to stipulating, as Mr. Dreyer suggests, except for the objection just made.

The Master. *As I recall it, there is expert testimony both ways on the matter as to whether or not they could be subdivided.*

Mr. Dreyer. That is correct.

Mr. Gaylord. If my recollection is correct, I believe Mr. Banker—I have forgotten the name of the other man who testified—testified he had not considered the property as subdivision property.

The Master. He said because he knew something about the cost of subdividing, and it could not be done.

Mr. Gaylord. He also placed the cost of the utilities at \$15,000 against \$4000.

The Master. I understand, but that is a difference of opinion there as to who is right." (R. 86 and 87.) (Emphasis supplied.)

From the foregoing it is obvious that the only question then before the Special Master was whether evidence as to present value was admissible. Whether evidence as to what the value would be if the plan were carried into effect would be admissible was not then before the Special Master. It is also obvious from the language italicised above that the Master

had in mind the testimony as to what the value would be if the property were subdivided and that he was giving consideration to it.

As the Special Master said, evidence was introduced by both sides as to what the value would be if the property were subdivided. Thus Mr. Thomas testified on behalf of appellee as follows:

“Q. Mr. Thomas, you stated you based your value on the laundry property in this case on the highest and best use to which the property can be put. In your opinion, what is that use?

A. Commercial.

Q. In what sense?

A. Well, it could be used for a skating rink, and ice rink, some kind of an amusement center. It really would have to be some kind of special use, I would say, where the people who used it could not afford to put much money into the land and still want a fairly good location. I took into consideration the potentialities, so far as residential is concerned. Due to the fact that the Federal Housing would not lend the money on the property in the vicinity, due to its blighted condition and type of residents, I think the highest and best use would be for some specialized line.

Q. *Have you given consideration, Mr. Thomas, to the value of the property subdivided into lots?*

A. *Yes, I have.*

Q. *In your opinion would a subdivision of the property increase or decrease its value?*

A. Decrease it.

Q. How?

A. Because of the cost that would be entailed in subdividing it, and the amount of available

property, and the fact that it would cost as much to build bungalows or flats there as it would in Pacific Heights, and the revenue would be very limited in proportion to what you could get in a better district.” (R. 29 and 30.) (Emphasis supplied.)

Mr. Banker testified, also on behalf of appellee, as follows:

“The Witness. A. Well, *we took into consideration what the property might be sold for if it was subdivided and utilities put in.* We subdivided the Oddfellows’ Cemetery and the Masonic Cemetery. I think both are located better than this. We sold the Oddfellows’ off at about 65 cents a square foot, and the Masonic at about 90 cents, after the utilities were in.

Mr. Dreyer. Q. What would be the cost of placing utilities in this property if it were subdivided?

A. We would have to figure that out carefully, but I would imagine if you cut one street through it would be 275 feet, that would be the frontage on each side of the street, and it would cost about \$15,000 to put in the utilities—between 12,000 and 15,000.

Q. What is the area of that property?

A. About 56,000 or 57,000 square feet.

Q. *By subdividing it would the value be increased or decreased?*

A. *Well, in my opinion you could not subdivide it and get \$30,000 for the property.”* (R. 31.) (Emphasis supplied.)

Mr. Bufford, appellant's president, principal stockholder and present counsel, testified on behalf of appellant as follows:

"Mr. Gaylord. Q. As to what, in your opinion, these lots, improved as outlined in the plan, can be sold for.

A. They will have a value of about \$2,000 a lot.

Q. Talking about improved, what is the sale price?

A. The land value.

Q. I am not asking the land value; I am asking what the lots, improved as outlined in the plan, will sell for.

A. About \$10,000 a lot.'" (R. 96.)

There is absolutely nothing in the record to indicate that the Special Master did not give due consideration to this testimony.

THE FINDING OF INSOLVENCY WAS WITHIN THE ISSUES.

Appellant contends that the question whether the appellant was insolvent is immaterial—that a plan of reorganization can be effected under Chapter X even though the debtor is insolvent. It is undoubtedly true (and appellee has never contended otherwise) that under Chapter X a plan can be effected notwithstanding the fact that the debtor is insolvent. But in such case the stockholders must be excluded from any participation. (*Case v. Los Angeles Lumber Products Co. Ltd.*, 308 U. S. 106.) And only the creditors are en-

titled to vote on any plan which may be proposed in the proceeding. (*In re 620 Church St. Building Corporation*, 299 U. S. 24.) Where the creditors have rejected a plan submitted by debtor or its stockholders and it is unlikely that they will accept another, the proceedings will be dismissed. (*Oakland Hotel Company v. Crocker First National*, 85 Fed. (2d) 959.) In other words, the creditors cannot be compelled to accept a plan against their wishes. The debtor and its stockholders have no interest in the matter and it is none of their concern whether a plan should be effected or not. The creditors, and the creditors alone, are the only parties in interest. If they decide, as in this case, that no plan should be effected, that ends the matter, and the debtor and its stockholders are in no position to object. The question of appellant's insolvency was, therefore, a material,—if not the most important,—issue in the case.

THE PLAN WAS NOT FAIR, EQUITABLE OR FEASIBLE.

Appellant next argues that the plan which it proposed was fair, equitable and feasible. The Supreme Court's decision in *Case v. Los Angeles Lumber Products Co.*, *supra*, demonstrates beyond question that it was not.

**THE COURT DID NOT ERR IN REFUSING LEAVE TO SUBMIT
AN ALTERNATIVE PLAN.**

The final argument advanced by appellant is that the court erred in refusing appellant leave to submit an alternative plan. It is clear from what has been said above that the court did not err in this respect. Sec. 236 of the Bankruptcy Act provides:

“if no plan is approved by the judge and no further time is granted for the proposal of a plan * * * the judge shall * * * (2) where the petition was filed under section 128 of this Act * * * enter an order adjudging the debtor a bankrupt * * * or dismissing the proceeding under this chapter, as *in the opinion of the judge* may be in the best interests of the creditors and stockholders.”

Whether upon disapproval of a plan the court should dismiss the proceeding or grant further time within which to propose another plan is entirely discretionary with the District Court. This court will not interfere with that discretion in the absence of a clear abuse thereof. (*Oakland Hotel Company v. Crocker First National Bank*, 85 Fed. (2d) 959.) Manifestly, there is no abuse of discretion in dismissing a petition and refusing to grant time to propose a further plan, where as here, it is unlikely, if not absolutely certain, that no plan can be effected which will comply with the Act as interpreted by the Supreme Court in *Case v. Los Angeles Lumber Products Co. Ltd.*, supra. In this connection attention should be directed to the fact that the court below in denying appellant's motion to reopen the case expressly found “that upon the facts of the case as presented to the Court and

upon the Report of the Special Master (heretofore approved), no plan could be proposed which would be acceptable under the provisions of the Bankruptcy Act * * *'' (R. 109.)

It is respectfully submitted that the order appealed from should be affirmed.

Dated, San Francisco,
March 2, 1942.

HERMAN PHLEGER,
MAURICE E. HARRISON,
HOWARD J. FINN,
Attorneys for Appellee.

BROBECK, PHLEGER & HARRISON,
A. M. DREYER,
Of Counsel.

No. 9985

United States
Circuit Court of Appeals
For the Ninth Circuit

SAN FRANCISCO LAUNDRY ASSOCIATION,
a corporation,

Appellant,

vs.

AMERICAN TRUST COMPANY,

Appellee.

PETITION FOR REHEARING

CHARLES M. BUFFORD,

1450 Turk St.

WEst 1941

San Francisco, Cal.

Attorney for Petitioner

FILED

APR 20 1942

Subject Index

	Pages
1. Case v. Los Angeles Lumber Co. is contrary to this court's decision: it holds a debtor, tho insolvent, may reorganize.....	2
2. Chapman Bros. Co. v. Security-First Bank does not support this court's decision: the findings, conclusions of law, and key facts were different.....	3
3, 4. The new money here secured, insured the debtor's solvency, and entitled it to reorganize.....	5

Table of Cases

	Pages
<i>Case. v. Los Angeles Lumber Co.</i> , Nov. 6, 1939, 308 U. S. 106, 60 S. C. 1, 84 L. 22, rh. dn. Dec. 4, 1939, 308 U. S. 637, 60 S. C. 258, 84 L. 529.....	2, 3, 4, 5, 6
<i>Castle Beach Apartments</i> , July 19, 1940, 2 Cir., 113 F. 2d 762.....	3
<i>Central Funding</i> , Feb. 11, 1935, 2 Cir., 75 F. 2d 256.....	3
<i>Chapman Bros. Co. v. Security-First Bank</i> , Apr. 10, 1940, 9 Cir., 111 F. 2d 86.....	2, 3, 4, 5, 6
<i>Consol. Rock Products v. DuBois</i> , Mch. 3, 1941, 312 U. S. 510, 61 S. C. 675, 85 L. 982.....	6
<i>Long Island Properties</i> , Jan. 29, 1942, 2 Cir., 125 F. 2d 206.....	5
<i>Marine Harbor Properties</i> , Jan. 10, 1942, 2 Cir., 125 F. 2d 296.....	3
<i>Prima Co.</i> , Mch. 3, 1937, 7 Cir., 88 F. 2d 785.....	5
<i>Western Pacific R. R.</i> , Nov. 28, 1941, rh. dn., 9 Cir., 124 F. 2d 136....	6

Citations of Bankruptcy Act

Sec. of Act	Sec. of 11 USC	Pages
77Bf	207f	4
116(2)	516(2)	5
144	544	2
146(3)	546(3)	2
176	576	3

PETITION

The appellant hereby petitions for rehearing.

In its opinion of affirmance, this court sums up the grounds of its decision as follows:

“It is plain that the debtor is insolvent in the bankruptcy sense; and that there is no reason to expect that a reorganization can be effected. Hence the proceeding was not instituted in good faith, sec. 146(3) of the Act, 11 USC 546(3), and the dismissal was proper, sec. 144, 11 USC 544. See *Chapman Bros. v. Security-First Nat. Bank of Los Angeles*, 9 Cir., 111 F2d86; *Case v. Los Angeles Lumber Co.*, 308 U.S. 106.”

1

The appellant respectfully represents that *Case v. Los Angeles Lumber Co.*, supra, cited by this court, does not support the foregoing statement, but is in fact contrary thereto.

In that case, the Supreme Court did not order dismissal of the reorganization proceeding; but, although pointing out that the bondholders' lien amounted to \$3,800,000, and that assets did not exceed \$900,000, and disapproving the proposed plan, expressly stated, 308 U. S. at page 131,

“Failure to accept this plan does not force dismissal or liquidation”,

and, 308 U. S. at pages 131 and 132,

“In this case there has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act cannot be adopted”,

and remanded the case to the district court for further proceedings.

Thus it cannot be doubted that *Case v. Los Angeles Lumber Co.* is direct authority for the proposition that a debtor though insolvent in the bankruptcy sense, may nevertheless effect reorganization under the Act.

This is also the necessary implication of the provision of sec. 176 of the Act, 11 USC 576, that where a corporation is insolvent, its stockholders shall not vote on the plan.

This is also the view of the 2nd Circuit,
Central Funding, 2 Cir., 75 F. 2d 256,
Castle Beach Apartments, 2 Cir. 113 F. 2d 762,
Marine Harbor Properties, 2 Cir., 125 F. 2d 296
 and coincides with appellee's admission on page 22 of its brief.

Hence the premise upon which the present decision is based, "that the debtor is insolvent in the bankruptcy sense; and that there is no reason to expect that a reorganization can be effected", is untenable. The district court did not find "that there is no reason to expect that a reorganization can be effected", or its equivalent; there is no evidence to sustain such a finding; and in the light of *Case v. Los Angeles Lumber Co.* it cannot be inferred as a matter of law.

Nor does *Chapman Bros. Co. v. Security-First Nat. Bank*, *supra*, also cited by this court in support of its present decision, in fact support it.

In the *Chapman Bros.* case, the district court found (see Record in that case, pages 88 and 89):

"That no plan of reorganization can be presented that can afford any relief to the debtor corporation"

“That the debtor corporation cannot evolve any plan of reorganization that would be fair and equitable and that would enable it to pay the creditors in full”

“That it is unreasonable for the debtor corporation to expect that any possible plan of reorganization could be effected.”

And, as this court recited, 111 F. 2d at p. 87, the district court concluded

“that appellant’s petition was not made in good faith; that ‘it was unreasonable for the debtor corporation to expect that any plan of reorganization could be effected.’ ”

In these respects the Chapman Bros. case is different from the present, for here there are no findings of fact or conclusions of law comparable to any of the foregoing. Indeed, herein the district court in its findings and decree was silent respecting such matters.

Moreover, in the Chapman Bros. case, the district court found (Record, page 88):

“That there is no possibility of debtor corporation securing any new working capital.”

Here, on the contrary, the plan discloses that such capital has in fact been secured.

Furthermore, in the Chapman Bros. case, this court based its decision on *Case v. Los Angeles Lumber Co.*, declaring it “directly applicable to the facts . . . for it was there held that any plan which required a secured creditor to share his inadequate security with an insolvent debtor was unfair and inequitable within the meaning of the Bankruptcy Act, sec. 77B, subd. f, 11 USC 207, subd. f.”

(In *Case v. Los Angeles Lumber Co.*, the plan cut down the bondholders’ lien and their participation in the debtor’s assets from

\$3,800,000 to \$641,375,—77 per cent of the value of the security, and allocated the remaining 23 per cent of the security to the debtor's stockholders.)

The present plan differs from all such plans, in that it does not propose that the secured creditor share an inadequate security with the debtor. It grants appellee preference as to its entire demand, except over new money spent in adding value to the security; and also provides for the early liquidation of the appellee's demand.

The Act expressly authorizes that new money be given an absolute preference, sec. 116(2), 11 USC 516(2), *Prima Co.*, 7 Cir., 88 F. 2d 785.

In this connection, *Long Island Properties*, 2 Cir., 125 F. 2d 206, published since the oral argument, is worth noting. The dispute before the Court of Appeals concerned a contract to complete a building program; but it appeared that the district court had previously authorized the issuance of \$76,000 of first lien certificates to finance the building program. Thus in that proceeding, what is here proposed, was in fact authorized.

In none of the prior reported decisions of this court holding against proposed reorganizations, have proposals to invest new money in profitable enterprises been involved.

In *Case v. Los Angeles Lumber Co.*, 308 U.S. at page 121, the Supreme Court declared:

“Where * * * the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.”

This case is distinguished from the Chapman Bros. case by two other crucial circumstances, to which this court has not referred in its opinion. The first is the provision in the plan (Rec. pp. 67 to 69) that the proposed dwellings be built progressively *and sold as completed*, with but six under way and unsold at a time, and that *the debtor's entire share of the proceeds* of such sales, over and above specified operating costs reasonable in amount, be applied at once to the retirement of appellee's demand *until paid in full*. The second is the unchallenged testimony (Rec. pp. 96 and 97) that the proposed sales will net the appellant about \$2,000 per lot,—about \$46,000 for the 23 lots,—an amount considerably in excess of appellee's gross demand.

These matters are important, not only as distinguishing this case from Chapman Bros. case, but in view of the declaration of the Supreme Court in *Consol. Rock Products v. DuBois*, 312 U.S. 510, at page 525:

“Findings as to the earning capacity of an enterprise are essential to a determination of the feasibility as well as the fairness of a plan of reorganization”,
a holding followed by this court in the *Western Pacific Railroad* case, 124 F. 2d, at page 138. (Such findings were not made in this case.)

The words of the Supreme Court in *Case v. Los Angeles Lumber Co.*, 308 U.S. at pages 131 and 132, are directly applicable to the present case:

“There has been no showing that a plan which is not only fair and equitable but also meets the other requirements of the Act

can not be adopted nor that all reasonable time for proposal of such alternative plans has expired.”

It is respectfully represented that rehearing of the present case should be granted, and this court’s decision modified in the light of this petition.

I hereby certify that in my judgment this petition is well founded, and not interposed for delay.

CHARLES M. BUFFORD,
Attorney for petitioner.

15
NO. 9989

United States 5
Circuit Court of Appeals
For the Ninth Circuit.

HYMAN HOWARD GOODMAN,
Appellant,
vs.
UNITED STATES OF AMERICA,
Appellee.

Transcript of Record

Upon Appeal from the District Court of the
United States for the Southern District
of California, Central Division.

FILED

FEB 27 1942

PAUL P. O'BRIEN,
CLERK

United States
Circuit Court of Appeals

For the Ninth Circuit.

HYMAN HOWARD GOODMAN,
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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

	Page
Appeal:	
Assignment of Errors on.....	133
Bail Bond on.....	12
Designation of Contents of Record on.....	141
Notice of Appeal.....	9
Statement of Points on.....	141
Arraignment and Plea.....	5
Assignments of Error.....	133
Attorneys of Record, Names and Addresses of	1
Bail Bond on Appeal.....	12
Bill of Exceptions.....	18
Closing Argument on Behalf of the Gov- ernment	116
Instructions of the Court to the Jury.....	118
Motion of Defendant Goodman for Directed Verdict	115
Order Denying	116
Motion of Defendants Keeler & Goodman for Instructed Verdict.....	84
Order Denying	84

Index	Page
Order Settling Bill of Exceptions.....	132
Stipulation re Bill of Exceptions.....	131
Witnesses for Defendants:	
Felker, W. A.	
—direct	98
—cross	98
Goodman, Hyman Howard	
—direct	99
—cross	106
—redirect	112
—recross	113
—by the Court.....	114
Keeler, Edward L.	
—direct	85
—cross	94
—redirect	97
Mackay, Robert	
—direct	115
Witnesses for the Government:	
Haig, Myron	
—direct	39
—voir dire	40
—direct	40
—cross	41
—redirect	41
Le Grand, Alex P.	
—direct	72

Index	Page
McCormick, William John	
—direct	56
—cross	70
—redirect	71
McDaniel, E. R.	
—direct	55
Nakauchi, Masaru	
—direct	50
—cross	54
Pollak, Edward	
—direct	56
Takahashi, Kenkichi	
—direct	20
—cross	33
—direct, resumed	33
—cross	34
—redirect	38
Takizawa, Kichiro	
—direct	45
—cross	49
—by the Court.....	50
—recalled, direct.....	72
Toombs, George	
—direct	42
Webster, Leslie E.	
—direct	44

No. 15091

Filed Oct. 22, 1941

Viol: Section 88, Title 18, United States Code (Conspiracy to violate Section 99, Title 50, United States Code, and Presidential Proclamation of July 2, 1940.)

In the District Court of the United States in and for the Southern District of California, Central Division.

INDICTMENT

At a stated term of said court, begun and holden at the City of Los Angeles, County of Los Angeles, within and for the Central Division of the Southern District of California on the second Monday of September in the year of our Lord one thousand nine hundred forty-one:

The grand jurors for the United States of America, impaneled and sworn in the Central Division of the Southern District of California, and inquiring for the Southern District of California, upon their oath present:

That

KICHIRO TAKIZAWA,
GEORGE M. NAKAUCHI,
KENKICHI TAKAHASHI,
HYMAN HOWARD GOODMAN,
ELWOOD L. KEELER, and
HIROSHI YAMAGUCHI,

hereinafter called the defendants, whose full and true names are, and the full and true name of

each of whom is, other than as herein stated, to the grand jurors unknown, each late of the Central Division of the Southern District of California, heretofore, towit: prior to the dates of the commission of the overt acts hereinafter set forth, and continuously thereafter to and including the date of finding and presentation of this indictment, did knowingly, wilfully, unlawfully, corruptly and feloniously conspire, combine, confederate, arrange and agree together and with each other, and with divers other persons whose names are to the grand

[2]

jurors unknown, to commit an offense against the United States of America and the laws thereof, the offense being to knowingly, wilfully, unlawfully and feloniously export from the United States to Japan, industrial diamonds, without authorization by a license of the Secretary of State as required by Presidential Proclamation dated July 2, 1940;

And the grand jurors aforesaid, upon their oath aforesaid, do further charge and present that at the hereinafter stated times, in pursuance of, and in furtherance of, in execution of, and for the purpose of carrying out and to effect the object, design and purposes of said conspiracy, combination, confederation and agreement aforesaid, the hereinafter named defendants did commit the following overt acts in the City of Los Angeles, County of Los Angeles, state, division and district aforesaid, and within the jurisdiction of the United States and of this Honorable Court:

1. During the month of August, 1941, the exact date being to the grand jurors unknown, defendant Hiroshi Yamaguchi furnished the sum of \$13,000.00 to defendant Kirchiro Takizawa:

2. On or about August 11, 1941, defendant Elwood L. Keeler sold to defendant Hyman Howard Goodman in the present of defendant Kenkichi Takahashi approximately \$2210.11 worth of industrial diamonds;

3. On or about September 4, 1941, defendant Elwood L. Keeler sold to defendant Hyman Howard Goodman in the presence of defendants Kenkichi Takahashi and Kirchiro Takizawa approximately \$3731.00 worth of industrial diamonds;

4. On or about September 16, 1941, defendants Elwood L. Keeler, Hyman Howard Goodman, Kenkichi Takahashi, Kirchiro Takizawa and George M. Nakauchi met at Los Angeles, California;

5. On or about October 16, 1941, defendant George M. Nakauchi had in his possession approximately \$15,000 worth of industrial diamonds; [3]

Contrary to the form of the statute in such case made and provided and against the peace and dignity of the United States of America.

WM. FLEET PALMER,

United States Attorney.

[Endorsed]: No. 15091. United States District Court, Southern District of California, Central Division.—The United States of America vs. Kichiro Takizawa, George M. Nakauchi, Kenkichi Taka-

hashi, Hyman Howard Goodman, Elwood L. Keeler and Kiroshi Yamaguchi. Indictment Vio: 18 USC 88. A true bill, W. A. Horrell, Foreman. Filed Oct. 22, 1941. R. S. Zimmerman, Clerk. Bail, \$10,000. [4]

At a stated term, to wit: The September Term, A. D. 1941, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Monday the 27th day of October in the year of our Lord one thousand nine hundred and forty-one.

Present: The Honorable Ben Harrison, District Judge.

No. 15,091-Crim.

UNITED STATES OF AMERICA,

Plaintiff,

vs.

KISHIRO TAKIZAWA, et al.,

Defendants.

This cause coming on for arraignment and plea of defendants Kishiro Takizawa, George M. Nakuchi, Kenkichi Takahashi, Hyman Howard Goodman, Elwood L. Keeler, and Hiroshi Yamaguchi; R. K. Lambeau, Assistant U. S. Attorney, appear-

ing as counsel for the Government; Leo Goodman and M. Seaton Cohen, Esqs., appearing as counsel for Defendant Goodman; J. Marion Wright, Esq., appearing as counsel for Defendants Takizawa, Nakauchi, Takahashi, and Yamaguchi; and Glen Behymer Esq., appearing as counsel for Defendant Keeler; all of the said defendants being present, Defendants Takizawa, Nakauchi, and Takahashi in custody, and Defendants Goodman, Keeler, and Yamaguchi on bond; and A. Wahlberg, Court Reporter, being present and reporting the testimony and the proceedings:

Each of the said defendants states his true name is as set forth in the Indictment. Defendants Goodman, Keeler, and Yamaguchi, respectively, plead not guilty, and it is ordered that the cause as to Defendants Takizawa, Nakauchi, and Takahashi be, and it hereby is, continued to 10 A.M., October 29, 1941, for plea. It is further ordered that the cause be, and it hereby is, continued to November 3, 1941, at 2 P.M., before Judge McCormick for setting for trial for defendants Goodman, Keeler, and Yamaguchi. [5]

[Title of District Court and Cause.]

VERDICT

We, the Jury in the above-entitled cause, find the Defendant, Hyman Howard Goodman, Guilty as charged in the Indictment; and find the Defendant,

Elwood L. Keeler Guilty as charged in the Indictment.

Dated: Los Angeles, California, November 27, 1941.

BEN P. GRIFFITH

Foreman.

[Endorsed]: Filed Nov. 27, 1941. R. S. Zimmerman, Clerk. By Murray E. Wire, Deputy Clerk.

[6]

District Court of the United States

Southern District of Calif.

Central Division

No. 15091-BH

Criminal Indictment in one counts for violation of U.S.C., Title 18, Secs. 88, consp. to violate 50 USC 99, and Presidential Proclam. of July 2, 1940.

UNITED STATES

vs.

JUDGMENT AND COMMITMENT

On this 1st day of December, 1941, came the United States Attorney, and the defendant Hyman Howard Goodman appearing in proper person, and by his attorneys, Leo Goodman, M. Seaton Cohen, Esqs. and,

The defendant having been convicted on verdict

of Guilty of the offense charged in the Indictment in the above-entitled cause, to wit conspiracy to unlawfully, etc. export from the United States to Japan, industrial diamonds, etc. and the defendant having been now asked whether he has anything to say why judgment should not be pronounced against him, and no sufficient cause to the contrary being shown or appearing to the Court, it is by the Court

Ordered and adjudged that the defendant, having been found guilty of said offenses, is hereby committed to the custody of the Attorney General for imprisonment in an institution of the Penitentiary type to be designated by the Attorney General or his authorized representative for the period of Two (2) years, and pay a fine unto the United States of America in the sum of Five thousand (\$5,000.) Dollars, not to stand committed for failure to pay said fine.

It is further ordered that defendant is remanded to the custody of the U. S. Marshal.

It is further ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer and that the same shall serve as the commitment herein.

(Signed)

BEN HARRISON

United States District Judge.

[Endorsed]: Filed Dec. 1, 1941. R. S. Zimmerman, Clerk. By Murray E. Wire, Deputy Clerk.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Name and Address of Appellant: Hyman Howard Goodman, 724 South Berendo Street, Los Angeles, California.

Name and address of Appellant's attorneys: M. Seaton Cohen and Leo Goodman, 629 South Hill Street, Los Angeles, California.

Offense: Violation of Section 88, Title 18, United States Code (Conspiracy to violate Section 99, Title 50, United States Code, and Presidential Proclamation of July 2, 1940.)

Date of Judgment: December 1, 1941.

Brief Description of Judgment or Sentence: That the defendant Hyman Howard Goodman is guilty of the crime of violating Section 88, Title 18, United States Code (Conspiracy to violate Section 99, Title 50, United States Code, and Presidential Proclamation of July 2, 1940.) as charged in the indictment; that he be imprisoned in a United States penitentiary at a prison designated by the Attorney General of the United States of America for two years and that he pay a fine to the United States of America in the sum of Five Thousand (\$5,000.00) Dollars. [8]

Name of Prison where now confined, if not on bail: Remanded and now held by the United States Marshal at Los Angeles County Jail.

I, the above-named appellant, hereby appeal to the United States Circuit Court of Appeals for the

Ninth Circuit from the Judgment above-mentioned on the grounds set forth below.

HYMAN HOWARD GOODMAN
Appellant.

Dated: December 3, 1941.

M. SEATON COHEN
LEO GOODMAN

By M.S.C.

Attorneys for Appellant.

GROUND OF APPEAL

1. That there is no evidence to sustain the verdict.

2. That the verdict is contrary to the evidence.

3. That the verdict is contrary to the law.

4. That the verdict is contrary to the facts.

5. That the court committed numerous errors in ruling upon the admissibility of evidence and the various motions made by the defendant Hyman Howard Goodman and in instructing the jury, all of which were highly prejudicial to the defendant Hyman Howard Goodman, and in instructing the jury, all of which were highly prejudicial to the defendant Hyman Howard Goodman. [9]

6. That the Court erred in denying defendant Hyman Howard Goodman's motion to dismiss as to said defendant Hyman Howard Goodman at the close of the evidence for the United States.

7. That the Court erred in not directing a verdict of not guilty on the count as set forth in the

indictment returned herein on the ground and for the reason that the evidence was wholly insufficient to show that the defendant Hyman Howard Goodman was guilty of the crime as charged herein.

8. That the Court erred in making certain remarks in the presence of the jury prejudicial to this defendant Hyman Howard Goodman.

9. That Section 6 of the Act of Congress entitled "An Act to Expedite the Strengthening of the National Defense" approved July 2, 1940 and the Proclamation by the President of the United States of America, No. 2413, dated July 2, 1940, are unconstitutional in and for each of the following grounds: (1) That it is an unlawful deprivation of liberty, freedom and property without due process of law and contrary to the Constitution of the United States of America. (2) That the said Act of Congress and the said Proclamation constitute an unlawful delegation of power to the President and is void and unconstitutional.

10. That Section 6 of the Act of Congress entitled "An Act to Expedite the Strengthening of the National Defense" approved July 2, 1940 and the Proclamation by the President of the United States of America, No. 2413, dated July 2, 1940, are unconstitutional and void.

11. That the Proclamation by the President of the United States of America, No. 2413, dated July 2, 1940, is unconstitutional and void.

12. That by reason of the facts alleged in Paragraphs 9, 10 and 11 and the facts alleged in each

paragraph separately, the Court did not have jurisdiction to do any of the following acts: a) Try the defendant Hyman Howard Goodman on the charges herein. b) Sentence the defendant Hyman Howard Goodman on the charges herein. c) To do or perform each of the acts done and performed by the Court in the above-entitled case. [10]

13. That the District Attorney committed prejudicial error in his argument to the jury.

14. The Court erred in his refusal to give the instructions to the jury requested by this Defendant.

15. The Court erred in his instructions to the Jury herein.

[Endorsed]: Received copy of within notice this December 3, 1941. Wm. Fleet Palmer, U. S. Attorney. Filed Dec. 3, 1941. [11]

[Title of District Court and Cause.]

BAIL BOND ON APPEAL

Know All Men By These Presents:

That I, Hyman Howard Goodman, of the City of Los Angeles, California, as principal and Fannie Goodman and Fannie D. Ehrlich, as surety, are jointly and severally held firmly bound unto the United States of America in the sum of Twenty Thousand (\$20,000.00) Dollars for the payment of

which said sum we and each of us bind ourselves, our heirs, executors, administrators and assigns.

The condition of the foregoing obligation is as follows:

Whereas, later, to-wit, on the 1st day of December, 1941, at a term of the District Court of the United States, in and for the Southern District of California, Central Division, in an action pending in said Court in which the United States of America was plaintiff and Hyman Howard Goodman was defendant, a Judgment and sentence was made, given, rendered and entered against the said Hyman Howard Goodman, in the above entitled action, whereas he was convicted as charged in the indictment.

Whereas, in said judgment and sentence, so made, given, rendered and entered against said Hyman Howard Goodman, he was by said judgment sentenced to a United States penitentiary at a prison designated by the Attorney General of the United

[12]

States of America for two years and that he pay a fine to the United States of America in the sum of Five Thousand (\$5,000.00) Dollars.

Whereas, the said Hyman Howard Goodman has filed a notice of appeal from the said conviction and from the said judgment and sentence, appealing to the United States Circuit Court of Appeals for the Ninth Circuit; and

Now, therefore, the condition of this obligation are such that if said Hyman Howard Goodman shall appear in person, or by his attorney, in the United

States Circuit Court of Appeals for the Ninth Circuit on such day or days as may be appointed for the hearing of said cause in said court and prosecute his appeal; and if said Hyman Howard Goodman shall surrender himself in execution of said judgment and sentence, if the judgment and sentence be affirmed by the said United States Circuit Court of Appeals for the Ninth Circuit; and if the said Hyman Howard Goodman will appear for trial in the District Court of the United States, in and for the Southern District of California, Central Division, on such day or days as may be appointed for retrial by said District Court, if the said judgment and sentence against him be reversed,

Then this obligation shall be null and void; otherwise to remain in full force and effect.

HYMAN HOWARD GOODMAN

Principal.

724 S. Berendo Street, Los Angeles, California.

Address.

FANNIE D. EHRLICH

Surety.

731 So. Kingsley Dr.

Address.

Los Angeles, California

FANNIE GOODMAN

Surety.

724 So. Berendo

Address.

Los Angeles, California [13]

Approved as to form.

W. FLEET PALMER

United States Attorney

WM. FLEET PALMER

United States Attorney.

I hereby certify that I have examined the within bond and that in my opinion the form hereof is correct and surety thereon is qualified.

M. SEATON COHEN

LEO GOODMAN

Attorneys for Defendant and
Appellant.

The foregoing bond is approved this 5th day of
December, 1941.

DAVID B. HEAD

United States Commissioner

[Endorsed]: Dec. 8, 1941. [14]

Leo Goodman and M. Seaton Cohen
Attorneys for Defendant Hyman
Howard Goodman,
629 South Hill Street
Los Angeles, California
TRinity 8505.

In the District Court of the United States in and
for the Southern District of California, Cen-
tral Division.

No. 15019—BH Criminal

UNITED STATES OF AMERICA,

Plaintiff,

vs.

KICHIRO TAKIZAWA, GEORGE M. NAKA-
UCHI, KENKICHI TAKAHASHI, HYMAN
HOWARD GOODMAN, ELWOOD L. KEEL-
ER, and HIROSHI YAMAGUCHI,

Defendants.

ORDER EXTENDING TIME TO SETTLE AND
FILE BILL OF EXCEPTIONS OF DE-
FENDANT HYMAN HOWARD GOOD-
MAN

The defendant Hyman Howard Goodman having
taken an appeal on the 3rd day of December, 1941
from the judgment of his conviction herein and an
application having been made by him for an exten-
sion of time to settle and file the Bill of Exceptions

and there being no opposition by the United States Attorney:

It is ordered that the time in which the Bill of Exceptions of the Defendant Hyman Howard Goodman shall be settled and filed is hereby extended until January 9, 1942.

Dated at Los Angeles, California this 29th day of December, 1941.

BEN HARRISON

United States District Judge.

[Endorsed]: Filed Dec. 29, 1941. [15]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK

I, R. S. Zimmerman, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 17 inclusive contain full, true and correct copies of Indictment; Minutes of Arraignment and Plea; Verdict of the Jury; Judgment and Sentence; Notice of Appeal; Bail Bond on Appeal; Order Extending Time to Settle and File Bill of Exceptions; Praecipe for Transcript of Record on Appeal, and Stipulation for Elimination of Titles, which together with the Bill of Exceptions and Assignment of Errors transmitted herewith constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

I further certify that the fees of the Clerk for comparing, correcting and certifying the foregoing record amount to \$2.95, which amount has been paid to me by the Appellant.

Witness my hand and the seal of the said District Court this 29th day of January, A. D. 1942.

(Seal)

R. S. ZIMMERMAN,

Clerk,

By: EDMUND L. SMITH,

Deputy.

[Title of District Court and Cause.]

BILL OF EXCEPTIONS

Be It Remembered that the above entitled cause came on regularly for trial on the 25th day of November, 1941, at the hour of 10 o'clock A. M. of said day, before the Honorable Ben Harrison, Judge presiding in Department 6 of the District Court of the United States for the Southern District of California, Central Division, sitting with a jury duly and regularly impanelled and sworn.

The United States of America, plaintiff, appeared by Wm. Fleet Palmer, United States Attorney, and Leo V. Silverstein, Assistant United States Attorney, and the defendants, Kichiro Takizawa, George M. Nakauchi and Kenkichi Takahashi, having previously pleaded guilty to the charge in the indictment against them, and the defendant Hyman How-

ard Goodman being present in person and represented by his attorneys, Leo Good- [18] man and M. Seaton Cohen, and defendant Elwood L. Keeler being present in person, being represented by his attorneys, Glen Beyhmer and Ames Beterson, and the matter having been dismissed as to the defendant Hiroshi Yamaguchi upon motion and order therefor, and the jury having been regularly impanelled and sworn to try said cause aforesaid, the following proceedings were had and the following evidence, both oral, documentary and by stipulation was received, to-wit:

It was stipulated by all the parties that none of the defendants named in the indictment had a license authorizing or permitting them, or either of them, to export industrial diamonds from the United States of America, as required by law.

The witnesses, all of whom were duly sworn, then testified as follows: [19]

TESTIMONY FOR THE GOVERNMENT

Direct Testimony
of

KENKICHI TAKAHASHI

(Through an Interpreter)

Examined by Mr. Silverstein:

The Witness: I have pleaded guilty to indictment No. 15091 in which I was one of the defendants.

I know George M. Nakauchi, Hyman Howard Goodman, Keeler and Takizawa. I have known Takizawa since July and Nakauchi since June of this year.

I saw Goodman about the beginning of June of this year at my home on 58th Street, Los Angeles. My first conversation with him pertaining to industrial diamonds was at my home during June.

“Q. Would you state what the conversation was?

A. I said that I had an order for diamonds from Japan and if I were able to fill that order, I said I would like to purchase them.

Q. Was anything else said?

A. We talked about machinery.

Q. Anything else?

A. And I also talked about the purchasing of old stockings, ladies' old stockings.

*

*

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*

*

*

(Testimony of Kenkichhi Takahashi.)

“Q. What was said in that conversation that you had with Mr. Goodman about obtaining a license?

* * * * *

“A. I gave him the list, and I told him to obtain the license.

Q. What did he say?

A. He said he would try.

Q. What list were you referring to?

A. A number of articles on there. [20]

Q. Were there any articles or industrial diamonds on the list?

A. Yes; that was also on there.

Q. Was there anything else said in this conversation with Mr. Goodman pertaining to industrial diamonds?

A. We were talking about the diamonds right along during the whole conversation.

The Court: What were you saying about them?

The Witness: I only talked about the purchasing of the diamonds.

The Court: What were you saying about the purchase of the diamonds? Not what your conclusion was, but what did you say to him, in substance?

The Witness: I talked about the purchasing of the diamonds; nothing in particular; and then also talked about other matters.

(Testimony of Kenkichi Takahashi.)

The Court: What did Mr. Goodman say to you about the diamonds?

The Witness: He said that I would be able to purchase them through him.

The Court: Did you give Mr. Goodman any money at this time to purchase diamonds?

The Witness: Oh, no, I did not give him any money before I had actually made the purchase."

At this time a document was marked Government's Exhibit 1 for identification. Subsequently it was admitted into evidence as Government's Exhibit 1.

(All of the 22 exhibits in this case were introduced by the Government and none by the defendants. For brevity, the exhibits will therefore be hereinafter referred to merely as "Exhibits" without adding the word "Government's"). [21]

Exhibit 1 is a typewritten white sheet of paper as follows:

"H. H. Goodman
Los Angeles
California

3 carats scrap.....	\$1.35	\$4.05
2.05 carats Long NBG.....	1.10	2.26
2 carats lot 65.....	1.35	2.70
3.80 carats Lot Bortz.....	1.25	4.75
		<hr/>
		\$13.76
		.41
		<hr/>
		\$14.17"

(Testimony of Kenkichi Takahashi.)

The Witness: Keeler gave me Exhibit 1 at Goodman's place around the middle of June. The merchandise that appears on this list, Exhibit 1, I only purchased as samples.

Prior to the purchase of the articles listed (Exhibit 1), I was meeting Goodman all the time. I met him at Musto-Keenan Co. I went with Goodman to Musto-Keenan Co., where I met Keeler and we had a conversation. There were present Goodman, Keeler and myself. The conversation did not pertain to Exhibit 1, but to the purchase of more diamonds. That is why I purchased the samples beforehand from Keeler through Goodman. The articles that appear on this list (Exhibit 1) were shown to me by Goodman before I purchased them. This was before I met Keeler. Exhibit 1 was given to me by Goodman at my home.

I had a conversation with Goodman concerning the samples at my home. No one else was present. I said I did not think the quality of the merchandise was very good; the color wasn't good. That is when we decided to go together to Keeler's place. I first went to Musto-Keenan Co. about a week or ten days after I received the samples. I went with Goodman and met Keeler. In the presence of the three of us, I said I wanted to purchase some more diamonds. Keeler explained the diamonds to me and asked me what I was going to use them for.

“Q. What did you say to him? [22]

(Testimony of Kenkichi Takahashi.)

A. I told him I did not know anything at all about diamonds; but I gave him the name of the people that sent me the order from Japan.

Q. Did you tell him where they were going to?

A. I don't think I said anything at that time.

* * * *

“Q. Did you say anything to him about the people who had requested you to get the diamonds? A. No, I did not.

Q. When did you first have a conversation with Mr. Keeler in which you told him where the diamonds were going to?

A. I did not tell him definitely where they were going.

* * * *

“Q. What did you say to Mr. Keeler?

A. I said this: I told him that I had received an order from Japan for these diamonds, and I told him that I had myself had no experience with these diamonds or any diamonds; and I said I was going to trust Mr. Keeler entirely, and I asked him to take that responsibility and to go ahead with it.

Q. What did he say?

A. He said that anything he would handle that I would not have to be afraid of losing any money on it.

(Testimony of Kenkichi Takahashi.)

Q. Now, was Mr. Goodman present when this conversation took place.

A. Yes; he was always there with me."

The Witness: The second time I went to Musto-Keenan's with Goodman, I ordered much better quality samples of industrial diamonds. I made arrangements to purchase everything through Goodman and gave Goodman all the money in Keeler's presence. I arranged with Goodman to give him 10% commission which was finally reduced to 5% with reference to purchasing industrial diamonds.

At this time a package containing diamonds was marked Exhibit [23] 2 for identification. Subsequently it was admitted into evidence.

The Witness: These are the samples that I received from Keeler. I took them with me and left them in my room in a brief case.

I went to Musto-Keenan Co. a number of times with Goodman and had conversations with Keeler with reference to diamonds. I always talked about the quality. I paid Goodman by cash and sometimes by check for the purchase of industrial diamonds. I have checks that I gave him before the account was closed and some that came back after the account was closed.

At this time Exhibit 3 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 3 consists of two notices by the Union Bank & Trust Company, Los Angeles, each entitled

(Testimony of Kenkichi Takahashi.)

“Notice of Returned Items.” Notice No. E3152 states that a check drawn by K. Takahashi for \$524.05 and deposited in the account of H. H. Goodman on July 25, 1941, had been charged to Goodman’s account for “Not sufficient funds.” Notice No. E3242 states that a check drawn by K. Takahashi for \$268.15 and deposited in the account of H. H. Goodman on July 26, 1941, had been charged to Goodman’s account for “Account closed.”

The Witness: I gave Goodman checks for \$268.15 and \$524.05 in July, 1941, for diamonds. I made good and paid cash for the checks that I had given Goodman after my account was closed.

At this time Exhibit 4 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 4 is a check drawn on the California Bank, First and San Pedro office, Los Angeles, dated August 9, 1941, to the order of K. Takahashi in the sum of \$1,228.95, signed by Kichiro Takizawa. It is endorsed by K. Takahashi. It is perforated “Paid 8/11/41.” [24]

The Witness: I took out the cash of this check and paid for diamonds.

At this time Exhibit 5 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 5 is a check drawn on the Yokohama Specie Bank, Ltd., Los Angeles branch, dated September 6, 1941, to the order of K. Takahashi in the sum of \$998.37, signed by H. Yamaguchi. It is en-

(Testimony of Kenkichi Takahashi.)

dorsed by K. Takahashi. It is perforated "Paid 9/6/41".

The Witness: I received this check, Exhibit 5, from Takizawa. The check was cashed and I paid the money to Keeler through Goodman for the purchase. I gave the money to Goodman.

At this time 10 sheets of paper were together marked Exhibit 6 for identification. Subsequently they were introduced into evidence.

The 1st sheet of Exhibit 6 is a typewritten invoice on blank white paper. It is dated July 7, 1941, and addressed to "H. H. Goodman, Los Angeles, California". It lists 8 lots of industrial diamonds for \$354.16, sales tax 3%—\$10.63, total \$364.79. On the left hand lower corner there appear in writing the words "Paid by check 7/7/41."

The 2nd sheet of Exhibit 6 is a typewritten invoice on blank white paper. It is undated and addressed to "H. H. Goodman, Los Angeles, California". It lists 6 lots of industrial diamonds and powder for \$5363.16, sales tax \$160.89, total \$5524.05. In writing there are added the words "commission \$536.31, total \$6060.36". It is signed by E. L. Keeler.

The 3rd sheet of Exhibit 6 is a similar invoice. It is dated July 28, 1941, and is addressed to "H. H. Goodman, Los Angeles, California". It lists 2 lots of diamonds for \$1630.00, sales tax \$48.90, total \$1678.90. In the lower left margin the figure "2094.75" appears in writing. [25]

(Testimony of Kenkichi Takahashi.)

The 4th sheet of Exhibit 6 is a similar invoice. It is dated July 30, 1941, and is addressed to "H. H. Goodman, Los Angeles, California". It lists 4 lots of diamonds for \$1947.15, sales tax \$58.41, total \$2005.56.

The 5th sheet of Exhibit 6 is a similar invoice. It is dated August 8, 1941, and is addressed to "H. H. Goodman, Los Angeles, California". It lists 3 lots of diamonds for \$262.96, sales tax \$7.89, total \$270.85.

The 6th sheet of Exhibit 6 is of white paper with the following words and figures in pencil:

"Amount	11,948	
Credit Cash	1,000	
	<hr/>	
	10,948	
Cr. Mdse.	1,527.40	
	<hr/>	
Balance	9,420.60	
Cr. Cash	7,900.00	
	<hr/>	
Bal. due Monday.....	\$1,520.60	on Mdse.
		received as security
		value \$1630.00
Klatersol	7.50	@ 2.25 1,687.50
Total	1,520.60	50.63
		<hr/>
	1,738.13	\$1,738.13"
	<hr/>	
	\$3,258.73	

The 7th sheet of Exhibit 6 is a typewritten invoice on blank white paper. It is dated August 11, 1941, and is addressed to "Mr. K. Takahashi, Los

(Testimony of Kenkichichi Takahashi.)

Angeles, California". It lists 9 lots of diamonds for \$3939.57, sales tax \$118.28, total \$4057.85. It also states: "Commission on \$3939.57 at 5%—\$196.98, total \$4254.83".

The 8th and 9th sheets of Exhibit 6 are duplicates of a printed invoice #1475 of Inter-Ocean Traders Bankers Building of Los Angeles. [26] It states: "Invoice of K. Takahashi, Los Angeles, California. Shipped from Los Angeles, Calif., to Los Angeles, Calif., via Personal Delivery". It lists 9 lots of diamonds by carat weight for \$17,932.17, sales tax \$537.97, total \$18,470.14, plus buyers commission 5% on \$17,932.17—\$896.61, total \$19,366.75. Credit by cash \$16,995.36. Balance due \$2371.39.

The 10th sheet of Exhibit 6 is a typewritten invoice on blank white paper. It is addressed to "H. H. Goodman, Los Angeles, California" and dated July 28, 1941. It lists 2 lots of industrial diamonds for \$1570.00, sales tax \$47.10, total \$1617.10.

The Witness: The 1st sheet of Exhibit 6 pertains to samples of industrial diamonds which they got for me and for which I paid on or about the date set forth in the exhibit. The 2nd and 3rd sheets are also for industrial diamonds. I paid Goodman for the diamonds and was along with Goodman when the merchandise was returned. All the other sheets pertain to diamonds and to merchandise that I returned to Keeler through Goodman. I received a memorandum similar to Exhibit 6 either from Goodman or Keeler.

(Testimony of Kenkichi Takahashi.)

During the months of June and July I purchased from Keeler or Musto-Keenan Co. about \$20,000 of industrial diamonds. In July, 1941, I purchased about \$8,000. I paid Goodman for all those purchases.

“Q. What did you do with the diamonds that were purchased during July of 1941?

A. I returned some of them.

Q. Did you send any of them away?

A. No, I did not send them.

Q. Did you give them to anyone to send away?

A. I gave them to Mr. Nakauchi.

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“Q. Did you ever have a conversation with Mr. Keeler about hearing from anyone in Japan regarding diamonds that had been sent?

A. No, I did not.” [27]

The Witness: I discussed with Keeler the quality of the diamonds and told him I didn't think the quality of the first sample was very good. I spoke occasionally about the quality and that the price was very high.

“Q. Did you say anything to him about anyone advising you as to the quality or the price?

A. I told him that I had received letters quite a bit from Japan in which they referred quite a lot to the quality; I told him that.

(Testimony of Kenkichichi Takahashi.)

Q. What did you tell him about those letters that you had received concerning the quality?

A. The demand that was made by Japan was that they wanted extra good quality; and I told him, not being experienced, even though not being experienced in diamonds, I didn't think the quality was very good.

Q. Was anyone else present when you told Mr. Keeler that?"

A. Mr. Goodman was there, and Mr. Takizawa was there at times."

The Witness: I remember twice when Takizawa accompanied Goodman and myself to Musto-Keenan Co. where we saw Keeler. I received and took delivery of industrial diamonds directly from Keeler in Goodman's presence on each occasion.

During August, I was at Musto-Keenan Co, upon quite a few occasions and purchased diamonds on these occasions. In September, 1941, I was taken by Goodman to the airport where I met Keeler and his wife. We then went to Keeler's home but I did not go inside the house. Keeler and I discussed industrial diamonds in Goodman's presence and I said that I would take delivery of an order in about two or three days. I was there 5 or 10 minutes, I think.

A few days later I met Keeler in Attorney Goodman's office in the presence of Goodman, Takizawa and Nakauchi. I had a conversation [28] there

(Testimony of Kenkichi Takahashi.)

with Keeler about taking delivery of industrial diamonds and about diamonds that I wanted to return. I then purchased diamonds from Keeler and paid Goodman about \$8,000 in Keeler's presence. Keeler and Goodman gave me the diamonds in the presence of Takizawa and Nakauchi.

At this time Exhibit 7 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 7 is a check dated September 16, 1941, drawn on the Citizens National Trust & Savings Bank, Los Angeles, to the order of H. H. Goodman in the sum of \$800, signed by T. Anraku. The check is not endorsed and is not marked "Paid" by any bank.

The Witness: I received Exhibit 7 from Nakauichi for diamonds. There wasn't sufficient money in the bank. Therefore, I gave Goodman \$550 in advance and asked him to hold this check; and after that I gave him \$250 in cash. The check was not cashed. I asked Goodman who was holding it to return it; but he said he had forgotten.

At this time Exhibit 8 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 8 is a typewritten invoice on blank white paper. It is undated and is addressed to "H. H. Goodman". It lists 1 lot of diamonds for 700 carats at \$5.60 per carat, price \$3920.00, sales tax 3%, \$117.60, total \$4037.60.

The Witness: This paper, Exhibit 8, recalls to my mind a purchase of industrial diamonds. I paid

(Testimony of Kenkichi Takahashi.)

the money to Goodman in Keeler's presence. Goodman gave the money to Keeler.

“Q. You never at any time had a license to export industrial diamonds, did you?

A. No, I never did.”

Cross Examination
of

KENKICHI TAKAHASHI

By Mr. Peterson:

The Witness: I was at the Musto-Keenan place of business approximately ten times. I went there during ordinary business hours and there were a lot of other people and employees there [29] at the same time. When I went to Keeler's house I did not get any industrial diamonds there. I spoke to Keeler directly in English.

At this time three packages of industrial diamonds were marked Exhibit 9 for identification. Subsequently they were admitted into evidence.

Direct Examination
of

KENKICHI TAKAHASHI

By Mr. Silverstein (resumed):

The Witness: These (Exhibit 9) are the industrial diamonds that I purchased through Musto-Keenan Co. and for which I paid Goodman. I delivered them to Nakauchi.

(Testimony of Kenkichi Takahashi.)

Cross Examination
of
KENKICHI TAKAHASHI

By Mr. Peterson (resumed):

The Witness: I am 51 years old. I am engaged in the export-import business. I have been going back and forth between Japan and the United States since 1907. I have no home in California and live with my nephew. I have imported and exported various things and articles between Japan and the United States. I came here last in May of this year.

I pleaded guilty to this charge and am out on bail awaiting sentence.

Cross Examination
of
KENKICHI TAKAHASHI

By Mr. Cohen:

The Witness: I saw Goodman a number of times. I came here on May 10th and saw Goodman about a week or ten days later. I told Goodman that I was going in business here and gave him a list of different kinds of merchandise that I was going to handle. In the list was machinery and silk stockings. After the Japanese assets were frozen and Japanese ships were not coming here, so that I could not return to Japan, I suggested to Goodman that it would be a good idea to buy old silk stockings, have them dethreaded and then sell the dethreaded silk to United States mills. [30]

(Testimony of Kenkichi Takahashi.)

“Q. Well, did you ask Mr. Goodman to help you get a warehouse and an office?

A. The reason for that way, at the time that I came, was when I was supposed to export silk stockings and other materials; and I also requested Mr. Goodman to procure for me export licenses for machinery that I was going to export.”

The Witness: I had known Goodman for about four years. I went to Goodman's office quite often and discussed going into business in Los Angeles with him.

“Q. There was no business with Japan then; the President had frozen the assets; and you were going to stay here and go into business; is that right?

A. No; the reason for that was that there were no ships to send the merchandise, and I could not return.”

The Witness: When industrial diamonds were first discussed, I knew that Goodman knew nothing at all about diamonds. Neither did I know anything about them at that time.

At the time I went out to the airport, I went to tell Keeler that I would have the money to take up the rest of the merchandise that I had ordered.

“Q. Now, then, you mentioned some letters from Japan. What letters did you get from Japan?

A. I got all kinds of letters from Japan.

(Testimony of Kenkichi Takahashi.)

Q. Did you get any letters from Japan on industrial diamonds? A. Yes.

Q. When? How long ago?

A. Also in July and August.

Q. They were written in Japanese to you, I suppose? A. Yes.

Q. You didn't show anything like that to Mr. Goodman, did you? [31]

A. No, I did not.

The Court: Did you tell him the contents of the letters?

The Witness: Yes.

The Court: What did you tell him?

By Mr. Cohen:

Q. What did you tell him about that?

A. I told him that they referred to the quality.

Q. Did you ever tell Mr. Goodman the name of any Japanese company that you were doing business with?

* * * * *

"The Witness: No, I never told him.

The Court: Did you tell him who you were buying the diamonds for?

The Witness: No. All I told him was that I was going to send it to Japan.

By Mr. Cohen

Q. When did you tell him that?

A. Right from the beginning.

Q. Was there any export order—did you

(Testimony of Kenkichi Takahashi.)

know whether you could send diamonds to Japan then or not?

A. That is why I asked Mr. Goodman to get an export license for me.

Q. And did you know whether or not anybody ever had an export license at that time to send anything to Japan?

A. I don't know anything at all about that.

Q. When was the first time the words "export license" were ever mentioned to you? Wasn't it after you were arrested?

* * * * *

"The Witness: No, it was not. [32]

"Q. When was the first time that you learned that you had to get an export license?

A. The first time that I gave Mr. Goodman the list of merchandise.

Q. Who told you then? Where did you get that information from?

A. I do not know from any particular person that I heard it, but I knew that I had to have an export license.

Q. Well, where did you learn it?

A. I don't remember."

The Witness: I paid Goodman for the diamonds at all times openly in the presence of Keeler. Two checks that I gave him were not good and checks that Goodman gave to Keeler came back. All Good-

(Testimony of Kenkichi Takahashi.)

man got out of this was a commission which was at first to be 10%, then it was cut to 5%. Out of the 5%, he was to rebate 2% to me. At the beginning he got 5% and I paid 5% for \$5,600.00. This 5% on \$5,600.00 is the only commission I ever paid him. I never paid him another nickel after that. The entire amount of commission that I paid Goodman was a check for \$268.15, which was returned when the bank account was closed. I made the money good afterwards.

I did not know the market price of diamonds and did not take them elsewhere to get them appraised.

I ran a business, a store in Los Angeles, from 1908 to 1916. After those eight years, I was in Los Angeles again for a good many years. I came off and on twelve or thirteen times. I came here for purchases. I was in partnership with the Kio Busan Company in Los Angeles for about three months.

Redirect Examination
of

KENKICHI TAKAHASHI

By Mr. Silverstein:

The Witness: When I went to Musto-Keenan Co. I went into a private office where I saw Keeler.

[33]

Direct Examination
of

MYRON HAIG

By Mr. Silverstein:

At this time Exhibits 10 and 11 were marked for identification. Subsequently they were admitted into evidence.

Exhibits 10 and 11 are two books labeled "Abrasive Cash Sales" of Musto-Keenan Co., Nos. 17 and 18. Each book contains carbon copies of orders and sales memoranda in numerical sequence. The data in these Exhibits which pertain to this case are:

Order No.	Date	Sold to	Item	Price	Sales Tax	Total Price
			Bortz & 10.95			
A 1265	6/30/41	Cash	cts. Diamonds	\$13.21	\$.40	\$ 13.61
A 1267	7/ 7/41	H. H.	Goodman Misc. Bortz	354.16	10.63	364.79
A 1275	7/22/41	"	Bortz	5136.97	154.11	5291.08
A 1280	8/ 1/41	"	Misc. Bortz	1570.00	46.10	1677.10
A 1287	8/11/41	"	"	2210.11	66.30	2276.41
			700 cts lot			
A 1298	9/ 4/41	"	1 1/3's diamonds	3731.00	111.93	3842.93
A 1312	10/ 1/41	"	Misc. Bortz	8115.29	243.46	8358.75

The Witness: I have been the accountant for Musto-Keenan Co. for four years. During the past year I have been in full charge of the accounting department. I am acquainted with Keeler. Exhibit 10 is a cash book. As cash sales are made, a copy is set in this book and copies are given to me. The other copy is kept in this book for record. I record from the original to my book. Exhibit 11 is similar

(Testimony of Myron Haig.)

to Exhibit 10. These Exhibits refer mostly to abrasives.

Exhibits 10 and 11 are records of Musto-Keenan Co. kept in the regular course of business by me as the accountant for the company. The writing in the sales book is Mr. Keeler's handwriting. I make the postings from the cash book, which I have in my hand.

Keeler is Secretary-Treasurer of the company and I work under his supervision. [34]

Voir Dire Examination
of

MYRON HAIG

By Mr. Peterson:

The Witness: Keeler has access to the books and those who work under him keep them under his direction. The books are kept in accordance with the ordinary practices of business.

Direct Examination
of

MYRON HAIG

By Mr. Silverstein (resumed):

The Witness: Order No. A 1265 shows a cash sale but not to whom it was sold.

All these sales in Exhibit 10 and 11 are in Keeler's writing and pertain to industrial diamonds. They show sales to H. H. Goodman except that the first item did not show to whom the sale was made.

(Testimony of Myron Haig.)

Cross Examination
of

MYRON HAIG

By Mr. Peterson:

The Witness: Musto-Keenan Co. has three departments, marble, tile and abrasive. The abrasive department includes grinding wheels, powder and diamonds.

My records are as complete and accurate as nearly as humanly possible. Keeler never told me to make any false or misleading statements in the books. Everything has been kept accurately and open and above-board.

Redirect Examination
of

MYRON HAIG

By Mr. Silverstein:

The Witness: Keeler receives a salary every week and at the end of each accounting period he gets 25% of the abrasive profits as a bonus. He does not receive anything until the end of the accounting period when the profits are fixed. If the abrasive department did not make any money he would not receive any bonus. The sale of the industrial diamonds involved in this case would be included.

The regular accounting period was December 31st but was recently changed to March 31st, so that it would not be determined until March, 1942. [35]

Direct Examination
of

GEORGE TOOMBS,

Examined by Mr. Silverstein:

The Witness: I am a teller in the Union Bank & Trust Company and I am familiar with its records. I brought some records from the bank.

The bank records show the following checks deposited to H. H. Goodman's account were charged back because they were not collected: \$524.05, July 26, 1941; \$268.15, July 29, 1941; \$1137.60, September 10, 1941.

At this time Exhibit 12 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 12 is a check dated July 24, 1941, drawn on the Union Bank & Trust Company, Los Angeles, to the order of Musto-Keenan Co. for \$291.08 and signed by H. H. Goodman. The check has the endorsement stamp of Musto-Keenan Co. There is attached to the check a *a* slip by the Union bank stating that the check was returned because of "Not sufficient funds".

The Witness: This check was returned because there was an overdraft created by the return to the Union Bank on July 26th of the check for \$524.05.

At this time Exhibit 13 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 13 is a check dated September 8, 1941, drawn on the Union Bank & Trust Company to the

(Testimony of George Toombs.)

order of Musto-Keenan Co. for \$1137.60, signed by H. Howard Goodman. The check is endorsed by the stamp of Musto-Keenan Co. The perforation reads "Paid 9/12/41".

The Witness: We had this item, Exhibit 13, returned on September 10 and we have it posted as of that date.

At this time Exhibit 14 was marked for identification. Subsequently it was admitted into evidence.

[36]

Exhibit 14 is a check dated July 7, 1941, drawn on Union Bank and Trust Co. to the order of Musto-Keenan Co. for \$364.79, signed by H. Howard Goodman. The check is endorsed by stamp of Musto-Keenan Co. The perforation reads "Paid 7/9/41".

The Witness: This check was posted against the account and created an overdraft, but on the same date there was a sufficient deposit to warrant paying that check and it was paid.

At this time Exhibit 15 was marked for identification. Subsequently it was admitted into evidence.

Exhibit 15 is a certification slip by Union Bank & Trust Co. It shows that the bank charged the account of H. Howard Goodman for certification of a check dated August 11, 1941, for \$500.00. The perforation reads "Paid 8/11/41".

The Witness: This certified check was charged against the account as soon as it was certified. It

(Testimony of George Toombs.)

was good as of that date and was immediately deducted from the account.

Exhibit 3 shows that two checks were charged against Goodman's account because they did not clear. The name of the drawer of the checks is Takahashi.

Direct Testimony
of

LESLIE E. WEBSTER,

Examination by Mr. Silverstein:

The Witness: I am assistant chief clerk of the Citizens Trust & Savings Bank of Los Angeles. I have the records of the account of K. Takahashi.

There is an item of \$524.05 which came in for payment on July 25, 1941, but was returned because of outstanding collections. There was an item of \$268.15 presented for payment on July 26, 1941, and returned because of "not sufficient funds". Both items were returned to the Union Bank & Trust Company. The account was closed on July 28, 1941.

[37]

Direct Testimony
of

KICHIRO TAKIZAWA

(Through an Interpreter),

Examined by Mr. Silverstein:

The Witness: I know Takahashi, Goodman and Keeler. I have known Takahashi since July of this year. I first met Keeler in July before I met Takahashi. I met Keeler when I went to Musto-Keenan Co. to find out the price of industrial diamonds.

I had a conversation with Keeler alone in the beginning of July, 1941, and asked him the price of diamonds. Keeler did not give me any list, but I had a list of industrial diamonds which I showed him. He said that the price would be the same as on the list. He asked me for what purpose I wanted the diamonds, but I did not say anything. At that time I did not place any order or purchase any diamonds from Musto-Keenan Co.

About a week later I went again to Musto-Keenan Co. and had a conversation with Keeler alone in his private office. I spoke about industrial diamonds and he told me that there were other people, mentioning Takahashi, placing orders for diamonds.

“Q. What did he say to you about Takahashi placing an order for industrial diamonds?

A. Mr. Keeler said that at first he brought him a list and that the list looked rather suspicious.

(Testimony of Kichiro Takizawa.)

Q. He said that you brought him a list that was suspicious? A. Yes.

Q. What did he say about it that made it suspicious?

A. He said, "Who brought up this list?"

Q. What did you say to him?

A. I didn't say anything.

Q. Now, when Takahashi's name was mentioned to you, was anything said further along that line?

A. Mr. Keeler said to me if I was going to purchase that together with Mr. Takahashi that it would be all right. That is all. [38]

Q. Was anyone else's name mentioned on that occasion? A. No.

Q. Was Mr. Goodman mentioned at all?

A. No.

Q. Was that the end of the conversation, or was there something else said?

A. He said that it would be very dangerous if I did not purchase the diamonds together with Mr. Takahashi.

Q. Did he give you any price list different than the one that had been given to you on the first occasion? A. No he did not."

The Witness: I saw Keeler again at about the beginning of August together with Takahashi and Goodman. I went alone to Musto-Keenan Co. and there found Takahashi, Goodman and Keeler. There

(Testimony of Kichiro Takizawa.)

was a conversation but I do not remember whether any diamonds were then purchased.

Takahashi, Goodman, Keeler and myself met again at the same place and had a conversation. Takahashi said that the quality of the diamonds was not very good. Keeler answered that according to the price it was the best.

“Q. Was anything else said?

A. Mr. Takahashi said that there was a big order coming from Japan and he wanted Mr. Keeler to be very careful about the quality.

Q. Did Mr. Keeler say anything in response to that?

A. He said it would be all right.”

The Witness: I think they bought some diamonds then and I saw Takahashi give Goodman the money. I am not positive whether it was money or checks. Takahashi received industrial diamonds on that occasion. That was in the middle of August.
[39]

I did not receive any diamonds from Takahashi and I did not see anybody else receiving them from him. I do not know what happened to any of the industrial diamonds that were purchased by Takahashi during the month of July, 1941.

In the beginning of October I met Keeler, Goodman, Takahashi, and Nakauchi at Goodman's office. We had a conversation about industrial diamonds. Keeler brought the diamonds and showed

(Testimony of Kichiro Takizawa.)

them to Takahashi, the others and myself. Keeler said that that was a very good quality of diamonds. Takahashi then paid Goodman about \$8,000.00 by check and took delivery of the diamonds.

At this time Exhibits 16, 17 and 18 were marked for identification. Subsequently they were admitted into evidence.

Exhibit 16 is a check drawn on the California Bank, First and San Pedro Branch, dated September 5, 1941, to the order of H. H. Goodman for \$1137.60, signed by K. Takizawa. It is endorsed by H. H. Goodman. The perforation shows "Paid 9/8/41".

Exhibit 17 is a check drawn on the California Bank, First and San Pedro Branch, dated September 16, 1941, to the order of H. H. Goodman for \$200.00, signed by K. Takizawa. It is indorsed by H. H. Goodman. The perforation shows "Paid 9/16/41".

Exhibit 18 is a check drawn on the Yokohama Specie Bank, Ltd., dated September 14, 1941, to the order of the California Bank for \$1800.00. It is drawn and signed by H. Yamaguchi. It has the indorsement stamp of the California Bank. The perforation shows "Paid 9/16/41".

The Witness: The signature on the check for \$1137.60, Exhibit 16, is mine. I gave it to Goodman and it was cashed. I think I gave it to Goodman at Takahashi's home.

(Testimony of Kichiro Takizawa.)

“Q. Did it have anything to do with the purchase of industrial diamonds or payment of industrial diamonds? [40]

Q. Yes.”

The Witness: The signature on the check, Exhibit 17, is mine. I gave it to Goodman at Goodman's office on September 16th and it was cashed. It was in payment for industrial diamonds.

I received a check for \$1800, dated September 14, 1941, from Yamaguchi. It was used to purchase industrial diamonds. I gave the money from the check to Takahashi.

I pleaded guilty to the charge in this indictment on October 29, 1941.

Cross Examination
of

KICHIRO TAKIZAWA

By Mr. Peterson:

I am out on bail. Nobody made any promises that it would be easier for me if I testified for the Government.

I have been in the United States for 17 years. During the last five years I have been a commission salesman for refrigeration and electric appliances in Southern California, but not for diamonds.

I did not talk to anybody about the testimony I was going to give in this case before I took the witness stand. I never talked to Mr. Silverstein about what I was going to testify to and never

(Testimony of Kichiro Takizawa.)

told him anything about it. I did not talk to the agents of the Department of Justice or anybody else.

Examination of

KICHIRO TAKIZAWA

By the Court:

I went down myself to Keeler's office the first time with a list to inquire about industrial diamonds. I got the names of the concerns that were handling diamonds out of the telephone book. I had never handled industrial diamonds before. I had been asked by Nakauchi to go and investigate.

Direct Testimony of

MASARU NAKAUCHI

(Through an interpreter),

Examined by Mr. Silverstein:

The Witness: I pleaded guilty to the charge in this indictment on October 29, 1941. [41]

I know Takahashi, Takizawa, Goodman and Keeler. I never went to Musto-Keenan Co. I became acquainted with Goodman at Mr. Takahashi's in-law's home and met Keeler in Goodman's office in September, 1941. At that time Takahashi, Takizawa, Keeler, Goodman and myself were present. There was a conversation, mostly between Takahashi and Keeler, with reference to the quality of

(Testimony of Masaru Nakauchi.)

diamonds. I did not pay much attention but I saw payments of money by Takahashi to Goodman. I saw Keeler give something to Takahashi. I received three packages, Exhibit 9, from either Takahashi or Takizawa, I am not positive.

“Q. What did you do with them after you received them from either one of those persons?

A. As this was very valuable material, rather than to let anybody else have it, I kept them in my store.

Q. Where was that?

A. On a shelf in the store.

Q. What location?

A. 15471 South Western Avenue, Gardena.

* * * * *

“Q. Where did you put them?

A. On a shelf in my store.

Q. Had you received other industrial diamonds other than the ones that are before you as Exhibit 9?

A. Once before that time. I just kept them there.

* * * * *

“Q. You say that you did receive other diamonds? A. Yes.

Q. From whom?

A. I think Mr. Takahashi. I immediately returned them because the quality was bad. Mr. Takahashi said he was going to have them exchanged.

(Testimony of Masaru Nakauchi.)

Q. Other than that, have you ever received any other diamonds? [42]

A. Yes, once.

Q. From whom?

A. I think either Mr. Takahashi or Mr. Takizawa.

Q. And when was that?

A. The end of July, I think.

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“Q. What did you do with them?

A. I at one time had in my hand a bag or something that contained diamonds.

Q. What did you do with them after you received them?

A. I left them in a certain room in a hotel in San Francisco.

Q. You did that yourself? A. Yes.

The Court: Who gave you the diamonds?

The Witness: I think I received them from Mr. Takizawa.

The Court: Did you take them to San Francisco?

The Witness: My friend was returning to Japan and I chauffeured him up there.

By Mr. Silverstein:

Q. You chauffeured somebody that was going back to Japan? A. Yes.

Q. You drove somebody up north, is that it? A. Yes.

(Testimony of Masaru Nakauchi.)

The Court: You took the diamonds with you?

The Witness: I do not know whether I had the diamonds or not, but I understood—I heard that the diamonds were in that bag.

Mr. Peterson: That, of course, ought to be stricken.

The Court: Just a moment. I will find out. What bag?

The Witness: A portable phonograph. [43]

The Court: Who told you there were diamonds in there?

The Witness: Mr. Takizawa.

The Court: Is that one of the defendants in this case?

The Witness: The man that testified here before me.

Mr. Peterson: I now move to strike the testimony relative to the San Francisco episode upon the grounds that it has nothing to do with any of the issues in this case, entirely outside of the scope of this indictment; it is hearsay as against the defendant whom I represent.

The Court: It is a statement by a co-defendant. He said the satchel or bag contained industrial diamonds, and he took them to San Francisco.

Mr. Peterson: My recollection of his testimony is that he was told that they contained it.

The Court: He said one of the defendants

(Testimony of Masaru Nakauchi.)

told him. That would be binding, if there is a conspiracy.

Mr. Peterson: If it was within the scope of the indictment.

The Court: Objection overruled.

Mr. Peterson: Note an exception. May it be understood that if one of us makes an objection, it may be deemed by the other counsel."

FIRST EXCEPTION

Cross Examination of

MASARU NAKAUCHI

By Mr. Peterson:

The Witness: I have a small store and handle dry goods and dresses. I have been in California about three years and started from the beginning in the same business in Southern California.

I put the diamonds on a shelf in my store on Western Avenue. Keeler did not tell me to do that.

I happened to be up at the Bankers Building, where I saw the industrial diamonds, because I was riding in Takizawa's car, [44] so I just continued with him for the ride.

Direct Testimony
of

E. R. McDANIEL

Examined by Mr. Silverstein:

The Witness: I am a salesman for Musto-Keenan Co. and was so employed during June, July, August, and September of this year.

I know H. H. Goodman and saw him at the plant of Musto-Keenan Co. I gave Goodman some industrial diamonds as samples when Keeler was away. I saw Goodman there upon two or three other occasions. I also saw Takahashi there. I believe I saw another of the Japanese sitting here. I saw him more than once at the office of Musto-Keenan Co. with Keeler.

Industrial diamonds are used for a number of purposes, for lapping, truing, grinding wheels, making diamond saws, cutting vitreous ware, lapping tools, boring tools.

“Q. When you saw these gentlemen down there, there wasn’t any particular secrecy about it, was there? A. No, sir.

Q. Just came in looking like anybody else?

A. Yes, sir.

Q. Wasn’t hiding off in a room, locked up, or anything like that? A. No, sir.

Q. You weren’t whispering?

A. No, sir.

Q. Just talking like ordinary human beings do when they transact business, isn’t that correct? A. Yes, sir.”

Direct Testimony
of

EDWARD POLLAK,

Examined by Mr. Silverstein:

The Witness: I am vice-president and general manager of Musto-Keenan Company and held that position during June, July, August and September of this year.

I saw Goodman at the place of business of Musto-Keenan Co. [45] during those months on more than one occasion. On one occasion I saw him with Takahashi and on another occasion I saw him going through the hall.

Direct Testimony
of

WILLIAN JOHN McCORMICK

Examined by Mr. Silverstein:

The Witness: I am a special agent for the Federal Bureau of Investigation and have held that position since December 16, 1940.

I know Elwood Keeler. I first saw him on September 15, 1941, at approximately 5:00 P. M. at the Glendale Airport. I know H. H. Goodman, Takizawa, Nakaushi, Takahashi, and I also know Yamaguchi who is no longer a defendant in this case.

At this time 4 sheets of paper dated July 28 and July 30 were marked Exhibit 19 for identification. Subsequently they were admitted into evidence.

(Testimony of William John McCormick.)

Exhibit 19 consists of 4 typewritten sheets of blank paper and are two invoices (2 copies of each invoice). The 1st invoice, dated July 28, 1941, and is addressed to H. H. Goodman. It lists two lots of 400 carats of diamonds for \$1570.00, sales tax \$47.10, total \$1617.10. The 2nd invoice, dated July 30, 1941, and is addressed to H. H. Goodman. It lists 4 lots of 400 carats of diamonds for \$1947.15, sales tax, \$58.41, total \$2005.56.

The Witness: I saw Exhibit 6 on October 20 when the defendant Goodman gave it to me in the office of the Federal Bureau of Investigation and I had a conversation with Goodman concerning it. At that time Goodman was not under arrest.

“Q. What was the conversation concerning that exhibit that I have shown you?

A. Mr. Goodman presented these papers and stated that they were bills which he had received from Mr. Keeler. He stated that these bills were the bills [46] that he received for the purchase of the industrial diamonds mentioned in the statements. He stated that at the time of each transaction a bill had been drawn up—two bills had been drawn up: one in the amount that he paid to the Musto-Keenan Co. to Mr. Keeler and another one for an increased amount which had been given him by Mr. Keeler which he, in turn, gave to Mr. Takahashi, Mr. Nakauchi and Mr. Takizawa, and received from

(Testimony of William John McCormick.)

those three gentlemen the sum of money in the amount of the increased bill. He explained it by saying——

Q. What did he say; not what he explained. Just state what he said.

A. By saying that there was a false or a fictitious bill presented in order that he might receive a commission from the Musto-Keenan Co. from Mr. Keeler, and also receive a commission from Takahashi, Takizawa and Nakauchi.”

The Witness: I received Exhibit 8 from Takahashi and Exhibit 19 from Goodman. Goodman said that he had received it from Keeler.

“Q. Well, are they duplicates of the other exhibit?

A. He stated that the two statements dated July 28, one in the amount of \$1617.10 and the other in the amount of \$1678.90, had both been received by him, Mr. Keeler. He stated that he actually paid Mr. Keeler \$1617.10 for the purchase of the industrial diamonds shown on the statement which consisted of 400 carats. He stated that the other bill in the amount of \$1678.90 also for the same 400 carats of diamonds was received likewise from Mr. Keeler. He said that he took the bill in the amount of \$1678.90 and presented it to Mr. Takahashi, Takizawa and Nakauchi and received from them \$1678.90 and then paid Mr. Keeler \$1617.10. [47]

(Testimony of William John McCormick.)

Q. Are you finished?

A. No. On the bill dated July 30, 1941, in the amount of \$2005.56 he stated that this amount of money had been paid by him to Mr. Keeler, and he stated that he had presented a bill in a larger amount to Mr. Takahashi, Mr. Takizawa, and Mr. Nakauchi and received from them the increased amount, although he would only have to pay Mr. Keeler the face amount of this bill."

The Witness: I saw Exhibit 2 in a brown leather bag in a room occupied by Takahashi in Los Angeles. I saw Exhibit 9 consisting of three packages when they were located on a shelf in a dry goods store owned by Nakauchi on South Western Avenue and took them from that place.

At this time Exhibits 2-19, inclusive, previously marked for identification, were admitted into evidence without objection.

At this time a statement by the defendant Elwood L. Keeler, dated October 14, 1941, and consisting of eight sheets, was marked Exhibit 20 for identification.

The Witness: Elwood L. Keeler signed Exhibit 20 in my presence and my name appears as a witness. Mr. Holmes of the Federal Bureau of Investigation also appears as a witness. This was a free and voluntary statement on the part of Mr. Keeler.

(Testimony of William John McCormick.)

At this time Exhibit 20 was admitted into evidence against the defendant Keeler only and the Court instructed the jury that it was not to be considered in any sense as evidence against the defendant Goodman.

EXHIBIT 20

was then read to the jury. [48]

“Los Angeles, California, October 14, 1941

“I, Elwood L. Keeler, make the following voluntary statement to W. J. McCormick and Frank J. Homes whom I know to be Special Agents of the Federal Bureau of Investigation.

“I am in charge of the abrasive division of the Musto-Keenan Company located at 1801 South Soto Street, Los Angeles. I—ELK—handle—ELK—all purchases and sales of industrial diamonds for the company. During the past six months I, on behalf of the Musto-Keenan Company have purchased industrial diamonds from R. L. Patrick of Duluth, Minnesota,—ELK—J. L. Hanifer of New York City, and from Hanifer and Company in Spokane, Washington. These diamonds were loose diamonds. The value of the diamonds kept in stock by the Musto-Keenan Company average between \$10,000.00 and \$15,000.00 in value. This stock is kept in the vault in the office of the company and also in a safety deposit box in the name of the Musto-Keenan Company in the

(Testimony of William John McCormick.)

Vernon Branch of the Bank of America. E. G. Pollak, Myron Haig and myself have access to this safety deposit box in which—ELK the diamonds are kept.

ELK “During the past ten months the following firms and individuals have been the principal purchasers of industrial diamonds from the Musto-Keenan Company:

- (1) “Continental Drilling Co.
- (2) “Felker Mfg. Co.
- (3) “H. H. Goodman
- (4) “Thompson Products
- (5) “Processed Diamond Bit and Tool Company

“The Continental Drilling Company, Pacific Mutual [49] Bldg., Los Angeles have purchased about \$1500.00 worth of industrial diamonds to be used, I believe, on government contracts. These purchases are supervised by Jack Wilson of that company.

ELK “The Felker Mfg. Company located at Torrance, California have purchased at least \$10,000 worth of industrial diamonds since January 1, 1941. The purchases were made by M. N. Felker who appears to be the owner of the company. These purchases were made monthly. The diamonds are used by the company in the manufacture of a diamond cutting blade.

“H. H. Goodman, whose first name is Howard, and who claims to have an office at 629

(Testimony of William John McCormick.)

South Hill Street, Los Angeles, in the Banker's Building, has purchased \$15,000.00 or \$20,000.00 worth of industrial diamonds from the Musto-Keenan — ELK — Company since January 1, 1941. I personally handled these sales which were about ten in number. I do not know what business Goodman is engaged in. I have never been in his office and the only times I have seen him have been when he came to the office of the Musto-Keenan Company to purchase diamonds. H. H. Goodman appears to be purchasing diamonds for himself rather than as an agent. He has paid for these diamond purchases with his personal check and also by cashier's check and has always appeared at the company ELK unaccompanied by any other individual. Goodman never mentioned what sort of business he is engaged in and I know nothing further concerning him.

“The Thompson Products Company have purchased about \$1000.00 or \$1500 worth of industrial diamonds from the Musto-Keenan Company during the past few months. [50] This company is engaged in defense work.

“The Processed Diamond Bit and Tool Company of San Francisco, California by Fred Roland, owner or manager, have purchased about \$800.00 worth of industrial diamonds during the past ELK two or three months. I do not

(Testimony of William John McCormick.)

know what disposition of the diamonds is made by this company.

“The above are the only firms or individuals that I now recall as having purchased diamonds in the approximate amount of \$1000.00 or more.

“We, the Musto-Keenan Company, have sold no industrial diamonds for export nor does the company have a license to export industrial diamonds. We have not been approached by any firm or individual regarding the purchase of industrial diamonds for export.

“I have read the above statement and it is ELK true. It is given of my own free will and no threats or promises have been made to me.

“ELWOOD L. KEELER.

“Witnessed:

W. J. McCORMICK,

F. B. I., Los Angeles

“F. J. HOLMES,

Special Agent, F. B. I., Los Angeles.”

At this time a statement by the defendant H. H. Goodman, dated October 15, 1941, and consisting of 9 sheets, was marked Exhibit 21 for identification.

[51]

The Witness: I saw Exhibit 21 at the office of the Federal Bureau of Investigation at Los Angeles. It is a statement signed by Mr. Goodman freely and voluntarily on October 15, 1941.

(Testimony of William John McCormick.)

At this time Exhibit 21 was admitted in evidence against the defendant Goodman only and the Court instructed the jury that it was not to be considered as evidence against the defendant Keeler.

EXHIBIT 21

was then read to the jury.

“October 15, 1941, Los Angeles, Calif.

“I, Hyman Howard Goodman, make the following voluntary statement to W. J. McCormick and Frank J. Holmes whom I know to be Special Agents of the Federal Bureau of Investigation.

“In about April or May, 1941, I was contacted by K. Takahashi of 1560 W. 58th Street, Los Angeles, who had less than a week previous returned from Japan. Takahashi told me he was engaged in the business of purchasing American dollars from Japanese presently in America who were planning on returning to Japan. Takahashi said that in payment for these American dollars he, K. Takahashi, — H. H. G. — caused to be deposited certain amounts of Japanese yen in banks in Japan. He stated that the reason for these transactions was the fact that these Japanese returning to Japan were not allowed to take back American money with them. Takahashi said that as a result of these transactions he had a large sum of American money with

(Testimony of William John McCormick.)

which he wished to purchase industrial diamonds as an investment, Takahashi said that if I would arrange for him to purchase [52] industrial diamonds he would pay me a commission of 10% for my services. H. H. G. Later he told me he would only pay me a commission of 5% because the people with whom he associated in the transaction objected to a 10% commission. In May or June, 1941, I contacted Elwood Keeler of the Musto-Keenan Company of Los Angeles. I told Keeler I was acting as agent for K. Takahashi and that K. Takahashi wished to purchase industrial diamonds. Keeler agreed to add on to the bill about 3 or 4% which was to be a commission for me. Since that time in May or June, H. H. G. 1941, I, acting as agent for K. Takahashi, made about four or five purchases of industrial diamonds from Elwood Keeler of the Musto-Keenan Co. These sales amounted to something more than \$14,000.00. On each of these sales Keeler allowed me to keep about 3 or 4% of the purchase price as my commission. K. Takahashi was usually with me when I discussed these industrial diamonds purchases with Keeler at the Musto-Keenan Company. Takahashi entered into and took part in these conferences with Keeler. Takahashi at each sale insisted that Keeler deliver the diamonds to him H. H. G. personally. On one occasion when I was present Takahashi re-

(Testimony of William John McCormick.)

requested Keeler to weigh out one lot of diamonds to see that he was getting the correct weight. Keeler complied with this request and weighed out the diamonds.

“I received about \$800.00, more or less, H.H.G., from the Musto-Keenan Company on all of the sales. From Takahashi I received—H. H. G. between \$200.00 and \$300.00 in cash as my agent’s commission. Takahashi still owes me about \$800.00 H. H. G. or \$900.00 H. H. G. in commissions of which I am to return to Takahashi [53] personally $\frac{2}{5}$ of the total on these industrial diamond transactions.

“I presumed H. H. G. that it was illegal to export diamonds without a license H. H. G. but I did not know whether or not Takahashi planned to export these industrial diamonds. Takahashi gave several different reasons for wishing to purchase diamonds. At one time in July, August or September, 1941, he told me, ‘I cannot pay for H. H. G. the diamonds until the ship gets in.’ On another occasion during this period he said, ‘I will pay you your commissions when the boat arrives.’

“I do not know the individual with whom Takahashi is associated in business, except the following: H. H. G.

“..... Takizawa, who has been with Takahashi and me on one or two of the occasions when the diamonds were picked up at the Musto-

(Testimony of William John McCormick.)

Keenan Company. I do not know his first name or address.

“Nakauchi, whose first name or address is unknown to me, has been up to my office at 629 South Hill with Takahashi during the past three months.

“On Monday, about September 15, 1941, I met Keeler on his return from Mexico. On Tuesday, the following day, Elwood Keeler, K. Takahashi, Takizawa, Nakauchi, and myself met H. H. G. in my office at 629 South Hill Street, Los Angeles, and we all discussed a diamond transaction and either at that time or a few days later Keeler delivered diamonds to K. Takahashi. There was only one meeting of business and/or group in my office.

“Although Takahashi agreed to pay me 5% commission, he has recently told me he would pay me only 3%.

“I have done business with K. Takahashi over a period of years when I was engaged in the importing [54] and exporting business. On all transactions I handled for Takahashi he paid me a commission as a buying or selling agent, on similar basis to this transaction.

“Takahashi does not know of the commission I received from the Musto-Keenan Company.

“I did not feel at the time I acted as agent in these transactions that I was violating any

(Testimony of William John McCormick.)

law of the United States but selling merchandise in the United States according to law.

“I have read the above statement consisting of eight and a fraction pages and it is true and no threats or promises have been made to me and it is given of my own free will.

“H. H. GOODMAN.

“Witnessed:

WM. J. McCORMICK,

Special Agent, F. B. I., Los Angeles

FRANK J. HOLMES,

Special Agent, F. B. I., Los Angeles.”

The Witness: On September 15, I went to the airport at Glendale. At about 4:45, I saw Goodman and Takahashi standing at the airport. At approximately 5:00 in the afternoon, the plane from Mexico City arrived and Keeler alighted from it and went into the office of the customs agent. I saw Goodman and Takahashi wait for about a half an hour at which time Keeler came out of the customs office.

As Keeler came out of the customs office, Goodman left Takahashi and went up to Keeler, talked to him, and walked with him over to the car operated by Goodman.

Takahashi was waiting at the car. Keeler and Goodman came up to the car and engaged in a conversation with Takahashi. Keeler was accompanied by his wife. Mr. and Mrs. Keeler, Goodman, and

(Testimony of William John McCormick.)

Takahashi then got into Goodman's automobile and they drove to [55] 3965 South Cherrywood Avenue. At that place, Mr. and Mrs. Keeler got out of the car and Mrs. Keeler went into the house. Keeler talked to Goodman and Takahashi for about ten or fifteen minutes, after which Goodman and Takahashi drove to 1560 West 58th Street, where Takahashi got out of the car.

I next saw Keeler on the following morning, September 16, at about 9:00. He left his home, went to the Vernon Branch of the Bank of America at 26th and Santa Fe Avenue and parked his car in front of the bank. In about fifteen minutes, Goodman drove up in his car, went over to Keeler and talked to him. Keeler then went into the bank and came out after about five minutes while Goodman stayed in his car.

Keeler then got into his car and drove it to a parking lot across the street. He then got into Goodman's car and they drove to 5718 South Baker Street where Goodman got out and went into the house. At that address Goodman was engaged in a conversation with some individual. He then left and went to 1560 West 58th Street and there he engaged someone in conversation.

Goodman came out, got into the car with Keeler, and drove away. As they were driving away, Takahashi came out of the house at 1560 West 58th Street and got into a car in which he, together with Taka-

(Testimony of William John McCormick.)

zawa and Nakauchi, went to a parking lot at 629 South Hill Street, next to the Bankers Building. They got out of the car and entered the building.

I took an elevator and went up to the 9th floor where I saw Nakauchi standing in the corridor. About an hour and a half later, Takahashi, Nakau-chi, Takizawa, Keeler and Goodman came out of the Bankers Building and were talking. They went to the parking lot where Takizawa, Takahashi, and Nakauchi got into one car and Keeler and Goodman got into the other car and drove away.

Cross Examination
of

WILLIAM J. McCORMICK

By Mr. Peterson:

The Witness: On October 14, 1941, Keeler came to my office [56] at the Federal Bureau of Investigation, Los Angeles, from the office of Musto-Keenan Co. I did not place him under arrest or tell him that he was under arrest. I talked to him at the Musto-Keenan Co. office for about two minutes and asked him if he would mind accompanying me to the office of the Federal Bureau of Investigation. He said he would be glad to and did so. He signed the statement at my office.

(Testimony of William John McCormick.)

Cross Examination
of

WILLIAM J. McCORMICK

By Mr. Cohen:

The Witness: Goodman's statement was written in longhand by myself and Goodman signed it. Goodman came up to my office willingly. He also furnished all the papers, documents, checks, etc., willingly. He gave up the papers and documents which he had. If I called him on the phone, he kept his appointment and came up to see me whenever I called him and asked him to be up at the office. He did so at all times.

Redirect Examination
of

WILLIAM J. McCORMICK

By Mr. Silverstein:

The Witness: Both Keeler and Goodman read their statements before they signed them.

Counsel stipulate that the two defendants on trial had no license to export industrial diamonds.

Direct Testimony
of
KICHIRO TAKIZAWA
(Recalled)

Through an Interpreter, Examined by Mr. Silverstein:

The Witness: I had no license to export industrial diamonds from the Secretary of State as required by the Presidential proclamation of July 2, 1940.

Counsel stipulated that if Takahasha and Nakauichi were recalled as witnesses, they would testify that they had no license to export industrial diamonds from the Secretary of State, as required by the Presidential proclamation of July 2, 1940. [57]

Direct Testimony
of
ALEX P. LE GRAND
(Recalled),

Examined by Mr. Silverstein:

The Witness: I have been a special agent of the Federal Bureau of Investigation since November 5, 1939. I saw Mr. Keeler on October 16, 1941, at the office of Musto-Keenan Co. together with special agent J. J. Maloney and we had a conversation with Mr. Keeler.

(Testimony of Alex P. LeGrand.)

“Q. What was the conversation?

A. First of all we asked Mr. Keeler if he would permit us to look at his records with reference to diamond transactions with H. H. Goodman, and he permitted us to do so. We also asked Mr. Keeler whether he had any transactions in diamonds with either Takizawa, Nakauchi or Takahashi, or any other Japanese; and he said he had never had any dealings in diamonds with any Japanese. We next asked him if any Japanese had been present during any of the times when he had dealings with H. H. Goodman, and he stated that no Japanese had ever been present at any time when he had dealings with H. H. Goodman. We then told him that a special agent of our Department had followed him to the office of H. H. Goodman sometime in September and had witnessed there his emergence from the office with Takahashi, Nakauchi and Takizawa; and that thereafter the Japanese persons mentioned had given us statements saying that they had been in the office with Mr. Keeler and Mr. Goodman at the time they purchased diamonds from Mr. Keeler. He then said that he remembered that there were some Japanese present in his office with [58] Goodman at the time he sold Goodman these diamonds. However, he said he did not know

(Testimony of Alex P. LeGrand.)

what the Japanese were up there for and he did not know that they had any connection with the diamonds. I asked him whether it was not true that Mr. Takahashi examined the diamonds at the time he showed them to Mr. H. H. Goodman. He said that that was true; that Mr. Takahashi did examine the diamonds and denied he showed the diamonds to H. H. Goodman. I then asked him if it was not true that a collection of money had been taken up from the Japanese, and after the collection of money had been taken up from the Japanese, that Goodman had wrote up a personal check which he handed to Mr. Keeler in payment of the diamonds; and he stated that that was true, that that had occurred and that a collection of money had been taken up among the Japanese; that he didn't know the amounts of the money; he didn't know what it was for; it could have been for any purpose; but he did not think it was for diamonds.

Q. Is that the substance of the conversation?

A. That is the substance of the conversation."

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"The Court: Mr. Silverstein, this last conversation is only admissible as to Mr. Keeler?

(Testimony of Alex P. LeGrand.)

Mr. Silverstein: That is all; it is just offered for that purpose.

The Court: There has been no distinction. I want to instruct the jury at this time that testimony relative to the conversation with Mr. Keeler is only binding as to the defendant Keeler, and is [59] not to be considered by you as evidence against Goodman."

At this time an additional statement by the defendant Keeler, dated October 17, 1941 and consisting of 5 sheets, was marked Exhibit 22 for identification.

The Witness: Exhibit 22 is signed by Keeler and witnessed by Le Grand. It was a free and voluntary statement.

EXHIBIT 22

is offered and admitted into evidence against the defendant Keeler only and read to the jury.

"Los Angeles, California, October 17, 1941.

"I, Elwood L. Keeler, give the following statement to Special Agent A. P. Le Grand, whom I know to be a Special Agent of the Federal Bureau of Investigation. This statement is made in the offices of the Federal Bureau of Investigation at Los Angeles, California.

"On June 30, 1941, Mr. H. H. Goodman came to my office at the Musto-Keenan Company,

(Testimony of Alex P. LeGrand.)

1801 South Soto Street, Los Angeles, California, and stated that he had a customer interested in purchasing industrial diamonds. He then bought a small amount of diamonds which he wanted to use as samples to show his customer. At this time Mr. Goodman asked me that any prices which I might quote on industrial diamonds before any other customer who might be a customer of Mr. Goodman be jacked up 5% to give him a profit. It was understood that I would bill Goodman for the real price of the diamonds.

“Several days later, Mr. Goodman came to the Musto-Keenan Company with K. Takahashi, and he and Takahashi inquired about quotations on diamonds and I showed them the diamond stock which Musto-Keenan Company then had on [60] hand. Takahashi also inquired about other grades of diamonds which Musto-Keenan Company did not have in stock, and Mr. Takahashi and Goodman asked me to obtain representative samples of these other grades of diamonds.

“Approximately July 7, 1941, H. H. Goodman and K. Takahashi again came to my office at Musto-Keenan Company and bought diamonds which are indicated on sales slip No. A-1267 dated July 7, 1941. Mr. K. Takahashi seemed to be an appraiser of diamonds and he

(Testimony of Alex P. LeGrand.)

examined the representative samples of diamonds which were purchased by H. H. Goodman on this day. At this meeting, Mr. K. Takahashi asked me some questions about the types of industrial diamonds which were on the market.

“Sometime in July, 1941, possibly toward the end of the month, a Mr. Takazawa came to my office alone and showed me a list of prices on industrial diamonds, and asked me if the prices listed therein were fair. He also asked me if I would sell him industrial diamonds and I refused to do so. I recognized the prices and the lot numbers which were on the list which Takazawa *showed* me as being similar to those which I had quoted to Mr. Goodman. I would not sell the diamonds to Mr. Takazawa for two reasons: First, I did not know Takazawa and, he being Japanese, I did not want to deal with him; and second, and chiefly, because I recognized the lot numbers and (ELK) prices as being similar to those on the list given to Mr. Goodman, and I felt that Mr. Takazawa was Mr. Goodman's customer inasmuch as this was the only quotation which was given out on that particular type, size and lot of diamonds. [61]

“About July 22, 1941, I sold the diamonds which are indicated on sales slip No. A-1275 in the amount of \$5,136.97, without including

(Testimony of Alex P. LeGrand.)

tax, to Mr. H. H. Goodman when he came to my office with Mr. K. Takahashi.

“About August 1, 1941, I sold diamonds indicated in sales slip No. A-1280 dated August 1, 1941, in the amount of \$1,617.00, without including tax, to Mr. H. H. Goodman at the offices of the Musto-Keenan Company when he came there with Mr. K. Takahashi.

“About August 11, 1941, I sold Mr. H. H. Goodman the diamonds indicated in sales slip No. A-1287 dated August 11, 1941, in the amount of \$2,210.00, without including tax. This transaction took place when Mr. Goodman came to the offices of Musto-Keenan Company with Mr. K. Takahashi.

“About September 4, 1941, Mr. H. H. Goodman came to the offices of Musto-Keenan Company with Mr. K. Takahashi and Mr. Takazawa, and at that time Mr. Goodman purchased the industrial diamonds indicated on sales slip No. A-1298 dated September 4, 1941, in the amount of \$3,731.00 without including tax.

“Several days before this meeting took place, Mr. Goodman, in (ELK) company with Mr. Takahashi, had discussed the purchase of \$11,055.00 worth of industrial diamonds and had left with me a deposit of approximately \$1,000.00 as evidence of good faith before I would order the diamonds from Jim Hanefen

(Testimony of Alex P. LeGrand.)

of New York City. The transaction of \$11,055.00 was conditional (ELK) on the fact that I would accept the return of diamonds indicated in lots Nos. 2854, 2845, and 2856, which total the amount of \$1,463.43, without including tax. While not definitely agreed upon, there was [62] a request that I also accept the return of diamonds indicated in lot No. 1850, amounting to 200 karats, and lot No. 1853, amounting to 200 karats. However, when Mr. Goodman came with Mr. Takazawa and Mr. Takahashi to conclude this deal, Mr. Goodman did not have enough money to take the whole order of diamonds of \$11,055.00. Instead, he purchased order No. A-1298 dated September 4, 1941, in the amount of \$3,731.00, and I did not accept the return of any diamonds at this time. At the conclusion of this deal, Mr. Goodman still had a deposit of approximately \$1,000.00. Goodman stated that he would pay for the remainder of the diamonds by the time I returned from a vacation which I was to take shortly thereafter. Mr. Goodman asked me the day I expected to return from my vacation in Mexico, and upon my return on September 15, 1941, he met me at the airport with Mr. Takahashi. Mr. (ELK) Goodman drove my wife and me home and asked me to meet him on the following day to complete the sale of the diamonds.

(Testimony of Alex P. LeGrand.)

“On September 16, 1941, I went to the Vernon Branch of the Bank of America and got the diamonds which Goodman was going to purchase that day, from the safety deposit box of the Musto-Keenan Company. Mr. Goodman then met me outside of the bank and took me in his automobile to a place where he said Mr. Takahashi roomed. There he made inquiry for Mr. Takahashi while I remained in the automobile, and when he returned he told me that Mr. Takahashi was not there.

“We then went to Mr. Goodman’s offices at the Bankers Building, Los Angeles, California, where several minutes later Mr. Takahashi, Mr. Takazawa, and a Mr. Nakauchi arrived [63] and Mr. Goodman then discussed the purchase of the industrial diamonds which I had obtained at the safety deposit box. I opened the packages of diamonds and Mr. Takahashi examined them. I then wrapped the diamonds and gave them to Mr. Goodman. The Japanese took up a collection of money among themselves, which they gave to Mr. Goodman. I do not know the exact amounts of money which the Japanese present gave to Mr. Goodman. Mr. Goodman drew his own personal check which he gave me in payment for the diamonds. I do not remember the amount of the check which Mr. Goodman gave me.

(Testimony of Alex P. LeGrand.)

“As part of this transaction, I took back the diamonds indicated by lots Nos. 2854, 2845, and 2856, amounting to about \$1,463.40, which I credited to the total amount of \$11,055.00, and I also accepted the return of lots (ELK) Nos. 1850 and 1853, in the amount of about \$1,570.00, which I also credited in payment of the \$11,055.00. The check which Mr. Goodman gave me at this (ELK) time was of sufficient amount to bring the total purchase price of the diamonds up to the actual amount which I was charging Mr. Goodman for the diamonds, plus the 5% markup which I placed on the diamonds at the request of Mr. Goodman, who wished to have this 5% as his profit.

“About September 29, 1941, Mr. Goodman came to my office and took back the check which he had given me at his office on September 16, and in exchange gave me a check in the amount of about \$7,000.00, which, together with (ELK) the deposit which he had previously given of about \$1,000.00, paid in full for the diamonds which had been sold to him on September 16, with the exception (ELK) of an amount of [64] \$358.75. At this time he asked me if he might have a few days in which to pay the \$358.75 and I agreed to this. He returned a few days later and gave me a check in the amount of \$358.75, thus paying in full for the diamonds

(Testimony of Alex P. LeGrand.)

sold on September 16, 1941, at the correct prices which Mr. Goodman was supposed to pay for these diamonds.

"I have read the preceding statement, consisting of four pages, and I sign it because it is true as far as I can remember.

(Signed) "ELWOOD L. KEELER.

"Witnesses:

"A. P. LE GRAND, (signed)

"A. P. LE GRAND,

"Special Agent, Federal Bureau of Investigation U. S. Department of Justice Los Angeles, California.

"J. J. MALONEY, (Signed).

"J. J. MALONEY,

"Special Agent, Federal Bureau of Investigation U. S. Department of Justice Los Angeles, California.

"Upon further recollection I wish to make the following addition to the statement which I have made above: Sometime between July 7, 1941 and July 22, 1941, Takazawa came to my office and showed me a list of diamonds and lot numbers which I recognized as being similar to those which I had quoted to Goodman. He asked me to sell him about \$3,000 worth of the diamonds and I told him I would. Immediately after Takazawa left I phoned Goodman and asked him to come to my office. When he arrived

(Testimony of Alex P. LeGrand.)

I told him that Takazawa had been in the office and gave an order for diamonds similar to the one which I had quoted to Goodman. Goodman said that he did not know Takazawa. At this meeting I made a verbal understanding with Goodman that I would not [65] deal with any Japanese except through him. I ordered the industrial diamonds for Takazawa anyway because I thought that when they arrived I would tell (ELK) Takazawa that he would have to do business through Goodman and I thought that there would be no question about Takazawa buying the goods from Goodman because they would be at the same prices that I quoted him. Very shortly thereafter Takahashi came to the office with Goodman. I don't remember whether I told Takahashi that Takazawa had ordered some diamonds or whether he had learned from some other source, but he told me that he could give about \$30,000.00 worth of business in industrial diamonds if I would do no other business with any other Japanese unless I did it through Goodman. I then told Takazawa that he could not do any business in diamonds with Musto-Keenan Co. unless he did it through Goodman. I don't remember whether I phoned him this information or whether he came to the office and I told him there. (ELK)

(Testimony of Alex P. LeGrand.)

Takazawa authorized me to sell the diamonds he had ordered to Mr. Goodman and I did this.

(Signed) "ELWOOD L. KEELER.

"Witnesses:

"A. P. LE GRAND, (signed)

"A. P. LE GRAND,

"Special Agent,

"F. B. I., Los Angeles, Calif.

"J. J. MALONEY, (signed)

"J. J. MALONEY,

"Special Agent,

"F. B. I., Los Angeles, California."

Close of Government's Case

"Mr. Silverstein: The Government rests."

* * * * *

"Mr. Peterson: The Defendant Keeler now moves, at the [66] close of the Government's case in chief, that the Court instruct the jury to return a verdict of not guilty against the Defendant Keeler, as charged in the indictment, on the ground they have not sufficient evidence to warrant the case going to the jury.

"Mr. Cohen: The Defendant Goodman interposes the same motion.

The Court: Motion denied.

Mr. Peterson: Exception allowed to each defendant?

The Court: Exception allowed to each defendant."

SECOND EXCEPTION. [67]

TESTIMONY FOR THE DEFENDANTS

Direct Testimony
of

ELWOOD L. KEELER

(On His Own Behalf)

Examined by Mr. Peterson:

The Witness: I am Secretary-Treasurer and Manager of the abrasive division of Musto-Keenan Co.

At the time I became employed by the Musto-Keenan Co. in December, 1922, the company was in the marble and tile business. In connection with that business certain devices or machinery, known as cutting wheels, are used. These are various types of grinding wheels for cutting and polishing marble. I became the purchasing agent about a year later and naturally purchased many of them.

In connection with these cutting wheels, there are certain substances used known as industrial diamonds. These are used to true the edge of the wheel so as to produce a finer finish. The wheel is made of various types of aluminum oxide and silicon carbide bound with clays. It is known in the trade as carborundum.

(Testimony of Elwood L. Keeler.)

It is rather difficult to translate that into clearer English. They are specialty articles. They are an improvement over the old original emery wheels used for cutting, grinding and polishing. This is part of the use of industrial diamonds, but there are many other uses. They are used for the manufacture of diamond saws, boring and lapping. In fact, every day there are new uses found for them and it is difficult to recall them all. They are used in a variety of mechanical work, machine shops and practically all industrial firms.

The difference between an industrial diamond and the kind of diamond handled in the jewelry stores is that the jewelry store diamond is all carbon, a crystalline carbon, which is very clear. In the industrial diamonds, there are two kinds, carbon and Bortz. Carbon is black and entirely different from Bortz. Bortz comes [68] in various shapes, kinds, types and hardness. Not all diamonds are of the same hardness. It is rather intricate to go into details of the various qualities.

Industrial diamonds wouldn't do to wear on a ring on a finger. There are some industrial diamonds that are on the shade of gem stones, but they show the carbon spots and don't polish well. Our company is very busy on abrasive work and increasing all the time on account of the defense program. Practically all of our items are used in the defense program and all come under priorities.

(Testimony of Elwood L. Keeler.)

There are very few large suppliers of industrial diamonds. There are one or two outside of New York City, but New York City is the headquarters and is becoming more and more the headquarters for industrial diamonds. Originally they used to come, and I believe some still come, from Amsterdam and London to New York. We never purchased any from foreign countries, but mostly from New York. The industrial diamond is not found in the United States, although a few have been found in Arkansas, but none of them have proved satisfactory. Practically 99.9% are brought in from Brazil or South Africa, mostly from Africa. Apparently the English have control of the importing business of what is known as the Diamond Syndicate.

My first contact with Goodman was over the telephone a couple of weeks or so before the first sale that was made. He told me that he had seen our name in the telephone book and that he had a customer who wished to purchase industrial diamonds. He came to our place while I was away. After my return he came again and we discussed the purchase of diamonds. He asked me for prices and said that he would add to my quotations in order to make a profit for himself of 5%, 10% or 15%, for he was only acting as broker. We agreed that on all sales to his customer he would add 5%. He then took some samples with him for which he paid \$13.91.

Later he called up and said that the samples were not satis- [69] factory and that he was bringing his

(Testimony of Elwood L. Keeler.)

customer, a Japanese, to look at more diamonds. Three or four days later, he came with Takahashi. I showed him some of the diamonds in our own vault but they were not satisfactory. I then took them to the bank where I took more diamonds out of our safety deposit box and showed them various diamonds. The quality still did not seem to satisfy them. I asked them what price they wished to pay. They gave me a certain stipulated price which they would pay; I believe it was between \$3.00 and \$12.00 a carat. Industrial diamonds are sold by the carat. However, they did not seem to know much about diamonds and what they wanted.

So they gave me an order for some representative samples, which I immediately ordered through Mr. Hanifen in New York, who was in the business of selling industrial diamonds. The transaction is reflected by the first cash sale. When the diamonds arrived, I notified Goodman, who then came with Takahashi and took delivery of them. He paid for them at the time and the sale was entered up by myself in a separate cash book we keep for the abrasive division.

They came back in a few days, as reflected in our record book of sales, and ordered same representative amounts of samples. They didn't re-order all the samples, but picked out certain types and gave me the order. We again obtained the diamonds and billed them out in the regular order.

(Testimony of Elwood L. Keeler.)

On each occasion we made out two bills, in order to protect Goodman. One was the actual bill and represented the amount received by us and the other bill, which was presented to Goodman in the presence of the Japanese, was for a larger amount and included Goodman's commissions.

Takahashi complained about the quality of the second order and said that he didn't like their looks, but I told him that at the price he was paying it was impossible to get better goods. I [70] did not ask him for what purpose they were going to use the diamonds but told him to submit them to anybody who knew prices. I told him I would bring out a few samples of better goods but they would be more money. When he saw these, in the second order, he liked the appearance of them much better and was not satisfied with the ones he had already purchased. Some of the stones in the second order *seem* to please Takahashi more than the others and he started ordering more of that type.

So from then on he started ordering. The orders were for the higher priced diamonds. The last large order of about \$14,000 or \$15,000 was in August of this year. Takahashi insisted that I personally select the quality in the East. I told him that a trip East was too expensive and I would accept such a large order only if a substantial deposit was made so that the goods would be taken when they arrived. After several conversations they fi-

(Testimony of Elwood L. Keeler.)

nally put up a deposit of \$1,000 and promised to take the entire lot when it arrived.

Of course, between times Goodman and myself had several conversations, and it looked as if the money would be produced; and as a result I made arrangements to go East. I had a verbal order for the carats reflected in the last two sales. I then flew by plane to Chicago where I selected the diamonds which were shipped to the Bank of America by air-express. I left Friday night and was back Monday morning. The order for the diamonds was the sole purpose of my trip.

As soon as I returned I notified Goodman and then went with him, Takahashi and Takizawa to the bank and showed them the diamonds. They didn't take any of them at that time, but a few days later Goodman called up and said he would be down to take delivery of them. I went to the bank and brought the diamonds to our office. They came to our showroom, looked at the diamonds, but only took part of them, for which Goodman paid me. I believe the order was [71] for 700 carats and was the second from the last sale.

I then left for my vacation with Mrs. Keeler to Mexico City and returned by airplane in about ten days. I dropped Goodman a card from Mexico City, and Takahashi and he waited at the airport at our arrival. Before I left, I had naturally insisted that delivery be taken of all the goods I had ordered for

(Testimony of Elwood L. Keeler.)

them. Goodman offered to meet me on my return. When I arrived, I didn't expect Takahashi; I did expect Goodman.

We all drove to my home together, Mrs. Keeler went into the house and we talked for a few minutes outside. I told them that I was not going back to the office for a few days, but they said they had the money and would like to clean up the deal; finish taking delivery of the diamonds. So we made a date to meet in Goodman's office around 10 o'clock the next morning after I could go to the bank and get the diamonds.

The following morning I got the diamonds from the bank and at Goodman's suggestion, took them to Goodman's office. The three Japanese also came then. I put the diamonds on a table and there was some discussion as to raising the price to take care of them and also about returning some of the previous shipments which were not of as good a quality. Finally, I took back the various lots about which they complained, amounting to around \$2,500.00 to \$3,000.00. They then took the diamonds that I had brought and Goodman gave me a check for the full amount. We did not use this check but gave it back to Goodman a few days later when he gave us a check for the correct amount.

The circumstances under which my statement of October 14th was given were as follows: Mr. Holmes and Mr. McCormick came down to the office and asked to see me. When McCormick came in he

(Testimony of Elwood L. Keeler.)

flashed his card that he was from the F. B. I. and said he would like to know if I would come up to the office and talk to him. I said yes. They wanted me to go in their car, while I [72] wanted to follow in my own car. Finally they said, "Well, all right." But Holmes decided that he had better go with me and then went with me in my car.

When I got up to their office, they started questioning me about whom I had sold the diamonds to. I was there by myself. It was my first experience of anything of this type. Naturally, to be frank, I was just frightened; I was scared to death because I didn't know what happened or what was wrong. The fact that they didn't even let me drive up alone, while they didn't say I was under arrest, the fact that they stayed right with me all the time; I wasn't out of their sight—and I believe it was about 1:00 o'clock when they started taking down notes, and finally I believe it was at 1:00 o'clock they suggested that we go out and get some lunch. We went over across the street and got some lunch. Then I came back with them again; and I don't remember whether the statement was all written after lunch or whether it was started before lunch; but, as I say, I was frightened, and I really didn't know what I did say, plus the fact it was very warm; I had been suffering from dysentery; I wasn't feeling well.

Shortly after that, I believe just a day or two later, the second statement was taken. I believe

(Testimony of Elwood L. Keeler.)

that Mr. LeGrand came down at that time with Mr. McCormick and started asking me some more questions. So I asked that Mr. Pollack, our Vice-President and General Manager, come in. I started to give my story and they said "Well, let's go up to the F. B. I. office and finish it up there." So they were not down at the office very long.

Mr. Pollack did not go with me to the F. B. I. office when the second statement was given. As I recall, the second statement was taken down, a part of it was taken down at the office, but the whole statement was typed. It was taken down by the stenographer and typed afterwards. It was after 7 o'clock that night before I left there. The last part was typed by Mr. Le Grand. [73] This is a post-script and is in different handwriting.

I know I was there all afternoon, but I don't remember whether also some part of the morning or not. It was all afternoon at least, and I left at seven o'clock that night because I know that it was 8 o'clock by the time I got home.

I never had any conversation with the Japanese or anybody else relative to the industrial diamonds being exported to Japan and there was no understanding that that would be done.

I had no intention or purpose that any of these industrial diamonds would be exported to Japan or elsewhere and I entered into no agreement with anyone for that purpose.

(Testimony of Elwood L. Keeler.)

Cross Examination

By Mr. Silverstein:

The Witness: Prior to the dealings with the defendants in this case, Musto-Keenan Co. had sold industrial diamonds for 12 years. We never sold any of the larger firms or major concerns any amount of diamonds that compared with the amount that we sold to the defendants in this case. This didn't seem peculiar or strange to me for the reason that this year all lines of our business are increasing. There are several items, not only diamonds but other items, that we sold more of this year than the last few years put together and to people that were not large buyers or buyers at all. I didn't inquire of Goodman the extent of his financial ability because I told him that it would have to be for cash. When Goodman came with the Japanese it did not appear peculiar to me because there are plenty of Japanese in this country.

When I first did business with Goodman, he told me that he was buying for a customer. Then he appeared with Takahashi and thereafter Takahashi seemed to be the one interested in the diamonds who took the more active part. Takahashi did all the [74] questioning about the diamonds and their quality. As it went on the sales became larger.

Takizawa came alone at the beginning and had with him a copy of the price list of industrial diamonds which I had given Goodman. Then he came with Takahashi and Goodman.

(Testimony of Elwood L. Keeler.)

Up to that time I had not sold any industrial diamonds to Japanese. I asked Goodman or the Japanese what they were going to use the diamonds for. These diamonds are used for various industrial purposes.

I knew at that time that a proclamation had been issued by the President of the United States against the exporting of industrial diamonds without a license from the Secretary of State, our company having had knowledge about it immediately after the proclamation first came out.

My suspicions were not aroused and I didn't consider it necessary to inquire into the purpose that the stones were going to be used for. Even on the second and third occasions, my suspicions were not aroused.

The sales of diamonds to the defendants kept on increasing until the meeting in Goodman's office on September 16, when the largest order was put through. Whenever any of the sales were consummated, there was at least one Japanese present.

When I said in my statement of October 14 that no one was present on any of the occasions, I was scared to death. I felt that I had nothing to worry about, but on the other hand I didn't know what was wrong when I was examined by the Federal Bureau of Investigation, I gave the second statement after the agents had told me that they knew that the Japanese had visited my place and

(Testimony of Elwood L. Keeler.)

about the sales. I was very nervous at the first instance when I gave the statement of the 14th [75] right up to the time when I gave the statement of October 17.

“Q. As a matter of fact, you didn’t endeavor to give the agents the truth, or anywhere near the truth, until they had told you that they knew about the Japanese visiting your place and of the sale; isn’t that correct?

A. Well, that was the second statement.

Q. Well, whenever it was? A. Yes.

Q. At the same time or otherwise. That is a fact, isn’t it? A. Yes.

The Witness: In my statement of the 14th, I listed Continental Drilling Company, Felker Manufacturing Company, Thompson Products, and the Diamond Bit & Tool Company among several large concerns using industrial diamonds. Felker is the largest customer of this commodity and uses it for manufacturing diamond saws. Outside of Felker and Goodman, these other concerns purchased about \$1,000 worth of stones from us each year.

When Goodman came down to see me, I understood that he was acting as agent and he told me that he had a customer who wanted to buy industrial diamonds. When I said in my statement of October 14 that Goodman was acting for himself, I did not believe that Goodman was acting for himself.

(Testimony of Elwood L. Keeler.)

The amounts purchased by Goodman or by the Japanese through Goodman were not phenomenal quantities. Felker, which is a large company, had purchased more than that.

I didn't give any consideration to Takahashi as to what kind of business he had or what he was going to do with the goods. I was not interested. Nothing arose that caused me to be interested. We had no other Japanese customers.

Takahashi and Goodman told me that they had no knowledge [76] of diamonds but Takahashi kept talking about the quality not being good enough and wanted a better price. He examined the diamonds, looked at and sorted them, and then said that they should be of better quality. At no time did Takahashi say for whom he was purchasing them or what he wanted to use them for.

Redirect Examination

By Mr. Peterson:

The Witness: During the past year, Musto-Keenan Co. sold to Felker about \$15,000 of industrial diamonds. Felker began buying from us about 11 or 12 years ago. We are selling considerable to the U. S. Government and their subsidiaries today on defense products.

At this time two character witnesses testified for the defendant Keeler.

Direct Testimony
of

W. A. FELKER

Examined by Mr. Peterson:

The witness first gave character testimony on behalf of defendant Keeler.

The Witness: My company has purchased industrial diamonds from Musto-Keenan Co. through Keeler for about 12 years. In the last couple of years we purchased about \$24,000 worth.

Cross Examination

By Mr. Silverstein:

The Witness: We have had considerable business dealings with Musto-Keenan Co. who distributes all of our products.

At this time two more character witnesses testified for the defendant Keeler.

Direct Testimony
of

HYMAN HOWARD GOODMAN

(On His Own Behalf)

Examined by Mr. Cohen:

The Witness: I am 38 years old and was born in Butte, Montana. I have lived in Los Angeles on and off since 1919. In 1936, I went into the import-export business. [77]

I first became acquainted with Takahashi in 1937 at the office of my company, Inter-Ocean Traders. I saw him afterwards several times and spoke to him about business at my office. In 1941, Mr. Takahashi called me and told me that he had returned from Japan. I asked him to come up, which he did.

At my office Takahashi told me that he had a sizable sum of money and wanted to open a business here. He said that he wanted a warehouse and office, that he was going to buy a lot of heavy machinery, woolens, rags, and industrial diamonds. He said that he was particularly interested in getting women's old silk stockings which he was going to dethread and sell as thread to mills in the United States. He said that he was going to be in business with his nephew who was in the fruit business here. This was sometime in the middle of May. I did nothing about it at the time because I left for Montana on May 22.

After my return on June 18 Takahashi came to my office by appointment. He asked again about

(Testimony of Hyman Howard Goodman.)

renting a warehouse and the other matters and whether I had found out about the different items, including industrial diamonds. I said I would find out from a wholesale jeweler in the building and let him know.

I had never heard of industrial diamonds before, so I went to a wholesale jeweler on my floor in the Bankers Building. He told me that industrial diamonds were not regular commercial diamonds used by jewelers but that if I looked in the classified directory, I would probably locate a firm handling them.

I found Musto-Keenan Co. in the telephone directory and called for information. I was told that a Mr. Keeler was in charge of the department and that he was out of town for a few days. Up to that time I had never heard of Mr. Keeler. A few days later, I called Keeler on the phone and told him I had a [78] customer who was interested in industrial diamonds. He asked me what type and style but I answered that I knew nothing at all about industrial diamonds and would like to get a general idea of the prices, samples, etc. He suggested that I come over to see him at the office.

I met Keeler on June 30 at his office where I told him again that I knew nothing about diamonds, but that I had some Japanese buyers who I would bring over later, but in the meantime I wanted to make arrangements with Keeler and take some samples to the buyers.

(Testimony of Hyman Howard Goodman.)

I told Keeler that during the previous fall I had purchased some women's silk stockings for Takahashi to be shipped to Japan and that Mr. Takahashi at first agreed to pay me about 10% commission at that time, but then paid me much less. I told Keeler that as soon as Takahashi finds out where he can get the diamonds he will start cutting me down on commissions, and therefore I would like to arrange for a reasonable commission on these diamonds for which I could look to him—Keeler—so that if Takahashi cuts me down, I should have some sort of protection for my efforts.

Keeler answered that they do not give commissions, but in the usual course of business where customers are sent by other firms, they arranged a differential of about 4 or 5% between the gross price and the list price. We then arranged for this gross and list price on all billings.

At about the end of June I took Takahashi from his home where he had an office on West 58th Street to meet Keeler at Musto-Keenan Co.'s office.

I told Keeler that Takahashi was my customer and that he would like to see more samples in addition to the \$15.00 or \$16.00 worth of samples which I had bought previously. If they were [79] satisfactory, Takahashi would consider placing an order for industrial diamonds. Keeler said that he did not carry a full stock at the warehouse and would arrange with us to go to the Bank of America

(Testimony of Hyman Howard Goodman.)

where the stock was kept in a vault. We went to the bank where Keeler took the diamonds out of the vault and showed them to Takahashi and myself in open view of everybody.

Takahashi said that he didn't think the quality was exactly what he wanted and he asked Keeler if he would order a little better quality. Takahashi never said to Keeler or myself that he intended to ship these diamonds to Japan or that he had a customer in Japan to whom he intended to ship diamonds. Takahashi never gave me the names of any Japanese firms to whom he intended to ship industrial diamonds.

After that conversation, Takahashi purchased from Keeler diamonds for about \$300.00 and then there were also subsequent orders.

After the second purchase, Takahashi called me and asked me whether a certain Japanese, Takizawa, had contacted Keeler through me. I told him that I did not know Takizawa and that I knew nothing about Takizawa having contacted Keeler. I then arranged with Takahashi to go with him to Musto-Keenan Co. and talk to Keeler about it. Shortly thereafter Keeler called me and asked if I had sent a Mr. Takizawa to him, because Takizawa had a price list which was the same as Takahashi's. I told him that I was coming over the next day with Takahashi to talk about it.

The next day, I went over and picked Takahashi up at his home and took him to Musto-Keenan Co.

(Testimony of Hyman Howard Goodman.)

and had a conversation with Keeler. Keeler told us that Takizawa had come to his place with a list similar to the list that we had and had ordered merchandise from that list. Keeler presumed that Takizawa was associated with Takahashi or myself and on that basis he had taken the order and told me about it. Takahashi then said that Takizawa was one of his associates and that he could not understand why Takizawa had [80] ordered merchandise without him. Keeler then replied that he would prefer that Takahashi and Takizawa, inasmuch as they were associated, purchased material together and credited me with the sales, so that there would be no friction between the two.

About three or four days later, Takahashi asked me to take him to Musto-Keenan Co. because Takizawa would be there and the matter would be straightened out. I drove Takahashi to Musto-Keenan Co. and found Takizawa waiting for us. That was the first time I met Takizawa. This was about the middle of July. Takahashi or Takizawa then purchased some diamonds.

Generally I gave my check to Musto-Keenan Co. and Takahashi or his associate gave me the money to make good the check. Sometimes they paid by cash. The cash was counted out on the table and credited to me by Keeler. Whenever there was a check, I gave my check to Musto-Keenan Co. for the gross amount and later I would exchange that

(Testimony of Hyman Howard Goodman.)

for a check in a lesser amount, which was the customer's list price less my commission.

At one time I gave Keeler my check for \$7900.00 which he gave back to me a week later when I gave him my check for \$7000.00 and a few days later I gave him back the balance of \$350.00.

Before Keeler went to Mexico, there had been an order of diamonds that I had arranged which had not yet been taken up. Takahashi and Takizawa did not have sufficient money to take up the shipment before Keeler left for Mexico, but they said that they would have sufficient money to take up the balance of that merchandise the moment that Keeler returned from Mexico. Keeler then made arrangements to let me know when he got back from Mexico.

I received a card from Keeler saying that he would be back [81] on a certain day, I believe on a Monday. Takahashi and I met Keeler at the airport. I took Mr. and Mrs. Keeler and Takahashi to Keeler's home in my automobile. In front of Keeler's house Takahashi said that he was prepared to take the merchandise the next morning, but Keeler said that he was still on a vacation and had instructions not to return for another few days and therefore did not want to go back to the office.

However, Keeler wanted to get the money and deliver the merchandise. He said that he would go down to the bank where the merchandise was in the vault and close the transaction. I suggested that

(Testimony of Hyman Howard Goodman.)

they come to my office to close the deal and it was so arranged.

I met Keeler at the bank the next morning where Keeler got the diamonds. I then took him in my car to Takahashi's home in order to pick up Takahashi. When Takahashi came out of his house, he told me to go ahead and that he would come in a car in which were Messrs. Nakauchi and Takizawa were then driving up. I then drove Keeler to my office.

At my office there were present Keeler, Nakauchi, Takizawa, Takahashi and myself. This was about September 16th when the \$7900 check transaction took place. This was the last purchase.

I never met Takahashi, Takizawa, Keeler or any of them at night or at any other place than those mentioned here.

The entire amount of commission which I received from Takahashi and his associates was a check for \$268.15. That check bounced but Takahashi made it good. I also received commissions from Musto-Keenan Co. amounting to approximately \$700 or \$800.

When Takahashi and Takizawa were together their conversations were in Japanese which I do not understand.

I never entered into an agreement or understanding with Takahashi, Takizawa, Nakauchi, Keeler or anyone else to export [82] diamonds to Japan. I did not know that Takahashi had intentions of send-

(Testimony of Hyman Howard Goodman.)

ing diamonds to Japan without a license. It was not discussed with me. Takahashi did not tell me that he had no license nor did he ask me to obtain one for him. I never attempted to obtain a license to export diamonds to Japan.

At this time three character witnesses testified for the Defendant Goodman.

Cross Examination
of

HYMAN HOWARD GOODMAN

By Mr. Silverstein:

The Witness: I was associated in business with a company formed by Takahashi and known as the Tio Bussan Company. That company ceased doing business approximately March 27th of this year. I knew that Takahashi had been in the import-export business and that he had been established here for a number of years in some kind of curio store. I knew that Takahashi exported women's stockings a year or two ago, in the fall of 1939. I told Keeler that I had purchased some women's silk stockings from Takahashi and the details of the commission, but I cannot remember distinctly that I told Keeler that Takahashi had exported them. I told Keeler the first time that I purchased the \$13.00 item that I was an agent for a Japanese, but I did not mention the name. I introduced Takahashi to Keeler on the next occasion.

(Testimony of Hyman Howard Goodman.)

I did not ask Takahashi what he was going to do with these industrial diamonds because Takahashi had indicated to me that he was going to establish himself in a permanent business here, for the duration of the difficulties, at least. Takahashi and I did not discuss the purpose of buying these diamonds at all. I did not think it unusual for Takahashi to buy \$15,000 or \$20,000 worth of industrial diamonds, because Takahashi claimed to have a great deal of money that he had to invest in something, [83] and it seemed like it might be a wise investment to buy some item that would not lose its style or become outmoded, would have a ready market, and would not fluctuate very much in price. There was no way of knowing whether Takahashi had a lot of money, because when he bought the silk stockings I thought he did not have any money and then he went ahead and bought approximately \$8,000 to \$12,000 worth of stock.

I knew that on occasions several of Takahashi's checks came back and that my check came back. I knew that Takahashi had brought into the picture other Japanese whom I did not know previously. I knew that on some of these occasions checks were given by other Japanese who were not there when the transactions were taking place.

When Takahashi came to me previously, I believed that he had a tremendous yen fund and also that he had a yen fund on which he could raise all the American dollars that he wanted provided his

(Testimony of Hyman Howard Goodman.)

associates would get the money. I felt that he had plenty of funds with which to buy American dollars and that the reason he was not providing American dollars quickly enough was because he was not getting sufficient facilities as quickly as he expected.

I never asked him what he had done with the diamonds or why he did not sell them. Takahashi did not say anything about a license. I had never heard the words "industrial license" before and I had no knowledge as to that. Keeler never mentioned a word about an export license.

In my statement I said that Takahashi gave several reasons for purchasing diamonds and said at one time, "I can not pay for the diamonds until the ship get in." Every time it came to pay money Takahashi had various excuses and I did not attach any particular significance to that remark any more than to any other excuses. I figured that he was just stalling. The same [84] applies to another occasion when he said "I will pay your commissions when the boat arrives."

I received commissions of less than \$300.00. My entire commissions from Takahashi would have been \$896.00 less $\frac{2}{5}$ or approximately \$500.00. I did not receive my commissions over a period of about two months and upon the seizure of the diamonds and the arrest, I naturally inferred that I would never get my commissions.

(Testimony of Hyman Howard Goodman.)

My first actual business with Takahashi was in the fall of 1939 although I had known him since 1937.

"The Court: You testified, I believe, that when you first went to see Mr. Keeler about these industrial diamonds and told him that you had a customer that you were representing, and you say that you told him who it was at that time?

The Witness: I told him that it was a Japanese gentleman.

The Court: And you asked Mr. Keeler to arrange a price so that he could pay you a commission?

The Witness: That is correct.

The Court: What did you tell him was the reason for that?

The Witness: I explained to him that in previous dealings with Mr. Takahashi, that immediately he found out where the source of supply was, that he would start cutting down whatever commission that he had agreed to, and that eventually he would have the commission down to where it wouldn't pay me for my efforts, and that I would consider that I must have some sort of a protection in the form of a commission from the seller's side.

The Court: Well, you told him about the silk stockings experience, didn't you?

(Testimony of Hyman Howard Goodman.)

The Witness: Yes.

The Court: What did you tell him about that? [85]

The Witness: I told him that I had at another occasion purchased approximately 140 tons of silk stockings; that the price of silk stockings at the time I began to purchase them was set somewhere around \$120; that I had by maneuvering, and so forth, and the market was rather, you might say flooded, or there was a considerable amount of supply, greater than the demand, and I was able to get it down around \$80. When I asked Mr. Takahashi what he would pay me if I would get it at \$80, he told me he would pay me 10 per cent, which would be \$8.00 a ton. When he made the first purchase he paid me only \$2.00 a ton. When he got the last 30 tons he purchased, he cut it down to 50 cents; and I felt that any business that I would do with Mr. Takahashi in regard to industrial diamonds, regardless of what he promised me, that he would start cutting me down on my commissions, and that I wanted a fair protection from the seller's side.

The Court: Did you tell Mr. Keeler what Mr. Takahashi was doing with these stockings?

The Witness: I don't believe I did.

The Court: He didn't ask anything about that?

(Testimony of Hyman Howard Goodman.)

The Witness: I don't think he was interested in that.

The Court: He wasn't interested in it, about buying thousands of dollars worth of silk stockings, what he was doing with them, or anything?

The Witness: Of course, I can't recall any conversation relative to that.

The Court: These silk stockings were exported, weren't they?

The Witness: They were exported, dethreaded, made into men's silk hose and re-imported to this country.

The Court: So when you acted as agent for him at that time you knew that he was exporting the silk stockings?

The Witness: I was in full knowledge.

The Court: Yes; you knew it at that time. [86]

The Witness: That is correct.

The Court: At that time he kept cutting down, kept cutting down your commission?

The Witness: That is correct.

The Court: You figured that from these dealings with him, that he would do the same thing?

The Witness: That he would do the same thing, yes.

The Court: Yet you had no suspicion that these things were to be exported?

(Testimony of Hyman Howard Goodman.)

The Witness: At the time of the silk stockings—

The Court: No, these industrial diamonds.

The Witness: I had no suspicions because there couldn't—had there been any suspicion in my mind I would not have had to worry about him cutting down my commission.

The Court: You knew at the time that there had been an embargo on shipments of a good many things to Japan, did you not? That was a matter of common knowledge?

The Witness: That was a matter of common knowledge, that there was an embargo on some things.

The Court: A man that had just recently come from Japan approached you about a large purchase of industrial diamonds and you didn't think a thing about it so far as there being any law violating involved; I am asking that question.

The Witness: In consideration of other conditions, I did not.

The Court: That is all."

Redirect Examination
of

HYMAN HOWARD GOODMAN

By Mr. Cohen:

The Witness: In my statement where I said, 'I presumed it was illegal to export diamonds', when

(Testimony of Hyman Howard Goodman.)

he wrote that, he put that in, I tried to change the wording around so that it would mean that I presumed at the time. I had a splitting headache all night the night before.

The reason why I was not suspicious was that in view of Takahashi's wish to rent a warehouse and to go into a domestic business requiring heavy machinery, rags, women's stockings, etc., in view of [87] all those conditions, I had every reason to believe and did believe that he was permanently settled here for some time.

Recross Examination
of

HYMAN HOWARD GOODMAN

By Mr. Silverstein:

The Witness: I had every reason to believe that Takahashi had funds and the availability for converting them in time to make payments for the industrial diamonds. There is no way of stating in what period of time he might be able to convert a great deal of yen into American dollars. That would vary according to his ability to convert the yen.

(Testimony of Hyman Howard Goodman.)

Examination
of

HYMAN HOWARD GOODMAN

By the Court:

The Witness: I was given to understand that Takahashi was converting Japanese money into American dollars. I got that impression from what he told me. My impression was rather vague, but I believed that was the implication of his words. He was going to use the funds to purchase not only industrial diamonds but everything else.

What the Japanese were doing was transferring Japanese yen to the United States through exchange and using the American dollars for the purchase of diamonds. These American dollars represent funds received from the people in the United States and not from overseas. He was receiving dollars and giving in exchange yens in Japan. That was the source of some of his American dollars.

Direct Testimony
of

ROBERT MACKAY,

Examined by Mr. Cohen:

The Witness: I am associated with Goodman in some brokerage deals and make my office with him. I was present when Takahashi was in the office this year and heard the conversation between Takahashi and Goodman around the 15th of May of this year.

Takahashi told Goodman that he was going in the machinery business and wanted to rent a store for the business. Takahashi gave the impression that he had a lot of money. Takahashi said that he was going into the machinery business with his nephew and asked Goodman to find him a suitable location. Goodman said that he was going to Montana and would be gone for a while but would see what he could do. [88]

Conclusion of the Testimony

“Mr. Cohen: That is our case. Defendant Goodman rests.

Mr. Silverstein: No rebuttal. Government rests.

* * *

“Mr. Cohen: Defendant Goodman, if your Honor please, also moves for a directed verdict on the grounds and for the reason that the Government has failed to prove any of the ele-

ments constituting the crime of conspiracy or a violation of the Executive order of the President as of the date of July 2, 1940; for that reason, the directed verdict should be given the Defendant Goodman.

“The Court: Motion denied; exception noted.”

THIRD EXCEPTION.

During the Closing Argument on Behalf of the Government the Following Took Place:

* * *

“MR. Silverstein: Now let me say to you, this is a conspiracy charge, and if these defendants, or either of them, knew that the Japanese were purchasing these diamonds for export purposes, and they aided and abetted, they are guilty under the law with knowledge of the conspiracy, if we show that beyond a reasonable doubt, because they don't have to take active part; if they do anything in furtherance of the object of that conspiracy, with [89] knowledge of it, under the law they are a party to it, they are a partnership, they are an agent for one another; and if these Japanese took these diamonds, and there is evidence before you that Takizawa went up to San Francisco in an automobile with another Japanese who was leaving for Japan—I don't know whether those diamonds went aboard the boat; I say that you have a right to infer that they did; that they went aboard one of the

Japanese boats to get over to Japan—I say the evidence would give you the right to infer, after considering all of the evidence together, that that is just what took place, and that is what would have taken place on the other diamonds if they could have gotten away with it because there are ways that you know of to smuggle out of the United States.

Mr. Peterson: I want to take an exception to Mr. Silverstein's statement that the Japanese was going to San Francisco and then to Japan."

FOURTH EXCEPTION

"Mr. Silverstein: I didn't say that. I say there was a Japanese that was going to Japan.

The Court: The Court recalls testimony where Takizawa—I think that is the way you pronounce it—went to San Francisco with another Japanese who was leaving for Japan; and one of the witnesses anyhow testified that he took this Japanese friend that was going to Japan, *too* the diamonds to San Francisco, and the last time he saw them was in a hotel room.

Mr. Silverstein: That was Nakauchi, not Takizawa; [90] I was wrong about the name.

So, therefore, some of the diamonds undoubtedly reached over there because letters came back to Takahashi concerning the quality, and you have a right, I believe, to infer that, from

the facts we have shown you here, that logically, reasonably and honestly, and in all fairness to the defendant, you should conclude that they did reach there because of what came back and the conversations that Takahashi had with these defendants concerning the quality of the diamonds.”

* * *

THE COURT'S INSTRUCTIONS TO THE JURY

“The Court: Gentlemen of the jury, you have listened to the evidence; you have heard the arguments. The Court has heretofore read to you certain sections of the law upon which this indictment is based. I shall now give you the instructions as to the law of the case.

By the finding of an indictment no presumption whatsoever arises to indicate that a defendant is guilty, or that he has had any connection with, or responsibility for, the act charged against him. A defendant is presumed to be innocent in all stages of the proceeding until the evidence introduced on behalf of the Government shows him to be guilty beyond a reasonable doubt. And this rule applies to every material element of the offense charged. Mere suspicion will not authorize a conviction. A reasonable doubt is such a doubt as you may have in your minds when, after fairly and impartially [91] considering all of the evidence, you

do not feel satisfied to a moral certainty of the defendant's guilt. In order that the evidence submitted shall afford proof beyond a reasonable doubt, it must be such as you would be willing to act upon in the most important and vital matters relating to your own affairs.

Reasonable doubt is not a mere possible or imaginary doubt or a bare conjecture; for it is difficult to prove a thing to an absolute certainty.

You are to consider the strong probabilities of the case. A conviction is justified only when such probabilities exclude all reasonable doubt as the same has been defined to you. Without its being restated or repeated, you are to understand that the requirement that a defendant's guilt be shown beyond a reasonable doubt is to be considered in connection with and as accompanying all the instructions that are given to you.

In judging of the evidence, you are to give it a reasonable and fair construction, and you are not authorized, because of any feeling of sympathy or other bias, to apply a strained construction, one that is unreasonable, in order to justify a certain verdict when, were it not for such feeling or bias, you would reach a contrary conclusion. And, whenever, after a careful consideration of all of the evidence, your minds are in that state where a conclusion of innocence is indicated equally with a conclusion of

guilt, or there is a reasonable doubt [92] as to whether the evidence is so balanced, the conclusion of innocence must be adopted.

You are the sole judges of the credibility and the weight which is to be given to the different witnesses who have testified upon this trial. A witness is presumed to speak the truth. This presumption, however, may be repelled by the manner in which he testifies; by the character of his testimony, or by evidence affecting his character for truth, honesty and integrity or his motives; or by contradictory evidence.

In judging the credibility of the witnesses in this case, you may believe the whole or any part of the evidence of any witness, or may disbelieve the whole or any part of it, as may be dictated by your judgment as reasonable men. You should carefully scrutinize the testimony given, and in so doing consider all of the circumstances under which any witness has testified, his demeanor, his manner while on the stand, his intelligence, the relation which he bears to the Government or the defendants, the manner in which he might be affected by the verdict and the extent to which is contradicted or corroborated by other evidence, if at all, and every matter that tends reasonably to shed light upon his credibility. If a witness is shown knowingly to have testified falsely on the trial touching any material matter, the jury should distrust

his testimony in other particulars, and in that case you are at liberty to reject the whole of the witness' [93] testimony.

The defendants have offered themselves as witnesses and have testified in the case. Having done so, you are to estimate and determine their credibility in the same way as you would consider the testimony of any other witness. It is proper to consider all of the matters that have been suggested to you in that connection, including the interest that the defendants may have in the case, their hopes and their fears, and what they have to gain or lose as a result of your verdict. You are not limited in your consideration of the evidence to the bald expressions of the witnesses; you are authorized to draw such inferences from the facts and circumstances which you find have been proved as seem justified in the light of your experience as reasonable men.

There is nothing peculiarly different in the way a jury is to consider the proof in a criminal case from that by which men give their attention to any question depending upon evidence presented to them. You are expected to use your good sense, consider the evidence for the purposes only for which it has been admitted, and in the light of your knowledge of the natural tendencies and propensities of human beings, resolve the facts according to deliberate and cautious judgment; and while remem-

bering that the defendants are entitled to any reasonable doubt that may remain in your minds, remember as well that if no such doubt remains the Government is entitled to a verdict. [94] Jurors are expected to agree upon a verdict where they conscientiously do so; you are expected to consult with one another in the jury room and any juror should not hesitate to abandon his own view when convinced it is erroneous. In determining what your verdict shall be, you are to consider only the evidence before you. Any testimony as to which an objection was sustained, and any testimony which was ordered stricken out, must be wholly left out of account and disregarded. The opinion of the judge as to the guilt or innocence of a defendant, if directly or inferentially expressed in these instructions, or at any time during the trial, is not binding upon the jury. For to the jury exclusively belongs the duty of determining the facts. The law you must accept from the Court as correctly declared in these instructions.

The Court charges you that it is a well settled rule of law that if there are two reasonable constructions which can be given to facts proven, one favorable and the other unfavorable to a party charged with a crime, it is the duty of the jury to give to the accused that which is favorable to him and to his innocence rather than that which is unfavorable.

The Court instructs the jury that you should not be led to convict the defendants for the purpose of deterring others from the commission of like offenses, or for fear that a crime might go unavenged. No such reason can be sufficient to overcome that just and humane provision of our laws which says that no man [95] shall be convicted of a criminal offense unless his guilt shall be clearly established to a moral certainty and beyond all reasonable doubt.

You are further instructed that you are not to allow yourselves to be prejudiced in any manner against the defendants or either of them on account of the nature of the charge set forth in the indictment.

The good character of a defendant as to the traits involved under the charge, when such is shown, is a fact to be considered in connection with all the other facts and circumstances adduced in evidence and if, upon such consideration, the jury are not satisfied beyond a reasonable doubt of a defendant's guilt, they should acquit him. If, however, they are so satisfied that a defendant is guilty, they should convict him notwithstanding proof of good character.

Evidence may be either direct or indirect. Direct evidence is that which proves a fact in dispute directly, without an inference or pre-

sumption, and which itself, if true, conclusively establishes the fact. Indirect evidence is that which tends to establish the fact in dispute by providing another fact which, though true, does not of itself conclusively establish the fact in issue but which affords an inference or presumption of its existence. Indirect evidence is of two kinds, namely, presumptions and inferences. A presumption is a deduction which the law expressly directs to be made from particular [96] facts. Unless declared by law to be conclusive, it may be controverted by other evidence, direct or indirect. But, unless so controverted, the jury is bound to find according to the presumption. An inference is a deduction which the reason of the jury draws from the facts proved. This must be founded upon a fact or facts as is warranted by a consideration of the usual propensities or passions of men, the particular propensities or passions of the persons whose act is in question, the course of business or course of nature. The word "propensity" as used in this instruction means "natural or habitual inclination or tendency".

A fact proven to your satisfaction by proof of circumstances from a consideration of various items of indirect evidence, is nonetheless as effectively established as though it depended upon direct evidence. Such circumstances must be connected in such a way as to concur and

lead directly to the conclusion which may be indicated thereby.

The law under which the indictment in this case is drawn provides that if two or more persons conspire to commit any offense against the United States, and one or more of them does any act to effect the object of the conspiracy, each of the parties to such conspiracy is guilty.

In order to establish the crime charged, it is necessary, first, that the conspiracy or agreement to commit the particular offense against the United States as alleged in the indictment be established, and [97] secondly, to prove further that one or more of the parties engaging in the conspiracy has committed some act to effect the object thereof.

To constitute a conspiracy it is not necessary that two or more persons should meet together and enter into an express or formal agreement for the unlawful venture or scheme, or that they should directly, by words or in writing, state between themselves or otherwise what the unlawful plan or scheme is to be, or the details thereof, or the means by which the unlawful combination is to be made effective. It is sufficient if two or more persons, in any manner, or through any contrivance, positively or tacitly come to a mutual understanding to accomplish a common and unlawful design. In other words,

when an unlawful end is sought to be effected, and two or more persons, actuated by the common purpose of accomplishing that end, work together in any way in furtherance of the unlawful scheme, every one of said persons becomes a member of the conspiracy. The success or failure of the conspiracy is immaterial, but before the defendants may be found guilty of the charge it must appear beyond a reasonable doubt that a conspiracy was formed as alleged in the indictment, and that the defendants were active parties thereto.

In order to warrant you in finding a verdict of guilty against the defendants, or any of them, it is necessary that you be satisfied beyond a reasonable doubt that a conspiracy as charged in the indictment was entered into between two or more of the defendants to violate the law of the United States in the manner [98] described in the indictment. It is necessary further that, in addition to the showing of the unlawful conspiracy or agreement, the Government prove to your satisfaction, beyond a reasonable doubt, that one or more of the overt acts described in the indictment was done by one or more of the defendants or at their direction or with their aid.

Under the charge made the conspiracy constitutes the offense and it must be made to appear from the evidence, beyond a reasonable

doubt, before any defendant can be convicted, that such defendant was a party to the conspiracy and unlawful agreement charged, and that he continued to be such up to the time that overt acts were committed, if the evidence shows that there were any such. The mere fact that either or any of the defendants named may have engaged in the performance of any of the acts charged in the indictment as overt acts, would not authorize a conviction by reason of that fact alone, but it is necessary to show that such defendants or defendants were parties to the conspiracy and unlawful agreement before their guilt of the offense charged is made out.

Each party must be actuated by an intent to promote the common design. If persons pursue by their acts the same unlawful object, one performing one act, and a second another act, all with a view to the attainment of the object they are pursuing, the conclusion is warranted that they are engaged in a conspiracy to effect that object. Cooperation in some form [99] must be shown. There must be intentional participation in the transaction with a view and purpose to further the common design. And if a person, understanding the unlawful character of a transaction, encourages, advises, or in any manner, with a purpose to forward the enterprise or scheme, assists in its prosecution, he becomes a conspirator. And so a new party, coming

into a conspiracy after its inception, with knowledge of its purpose and object, and with intent to promote the same, becomes a party to all of the acts done before his introduction into the unlawful combination, as well as to the acts done afterwards. Joint assent and joint participation in the conspiracy may be found, like any other fact, as an inference from facts proved.

Where the existence of a criminal conspiracy has been shown, every act or declaration of each member of such conspiracy, done or made thereafter pursuant to the concerted plan and in furtherance of the common object, is considered the act and declaration of all the conspirators and is evidence against each of them. On the other hand, after a conspiracy has come to an end, either by the accomplishment of the common design, or by the parties abandoning the same, evidence of acts or declarations thereafter made by any of the conspirators can be considered only as against the person doing such acts or making such statements. The declaration or act of a conspirator not in execution of the common design is not evidence against any of the parties other than the one making such declaration.

The evidence in proof of the conspiracy may be cir- [100] cumstantial. Where circumstantial evidence is relied upon to establish the con-

spiracy or any essential fact, it is not only necessary that all the circumstances concur to show the existence of the conspiracy or fact sought to be proved, but such circumstantial evidence must be inconsistent with any other rational conclusion. That is, you are to consider all of the circumstances and conditions shown in evidence, and if it appears to you as reasonable men that, even though there is no direct evidence of the actual participation in the alleged offense by the defendants or either of them, a reasonable inference from all of the facts and circumstances does to your minds, beyond a reasonable doubt, show that the defendants, or some of them, were parties to the conspiracy as charged, then you should make the deduction and find accordingly.

It is not necessary that it be shown that any person concerned in the alleged conspiracy profited by the things which he did, but if any of the defendants, with knowledge that the law was designed to be violated in the particular manner charged in the indictment, aided in any way by affirmative action in the accomplishment of the unlawful act, they would be guilty. To this statement there is one exception, and that is, if before any overt act has been committed on the part of any conspirator or at his suggestion or with the aid or participation, any such conspirator withdraws from the con-

spiracy and wholly disassociates himself from the project or the carrying out thereof, he ceases to be a conspirator and is without guilt.

You are instructed that if I have said or done anything which has suggested to you that I am inclined [101] to favor the claims or position of either party, you will not suffer yourselves to be influenced by any such suggestion.

I have not expressed, nor intended to express, nor have I intimated nor intended to intimate, any opinion as to what witnesses are or are not worthy of credence; what facts are or are not established, or what inferences should be drawn from the evidence adduced. If any expression of mine has seemed to indicate an opinion relating to any of these matters, I instruct you to disregard it.

If in these instructions, any rule, direction, or idea be stated in varying ways, no emphasis thereon is intended by me, and none must be inferred by you. For that reason you are not to single out any certain sentence, or any individual point or instruction and ignore the others, but you are to consider all the instructions as a whole and to regard each in the light of the others.

The verdict to be rendered must represent the considered judgment of each juror.

In order to return a verdict it is necessary that each juror agree thereto. Your verdict must be unanimous.

When you retire to your jury room to deliberate, you will select one of your number as foreman and he will sign your verdict for you when it has been agreed upon. You will then return into court with the verdict and your foreman will represent you as your spokesman in the further conduct of this case in this court.

Forms of verdicts have been prepared for your [102] convenience, and when you have agreed upon a verdict, the foreman will sign the verdict upon which you agree and return it into court."

There were no exceptions to the court's charge and instructions.

The cause was then submitted to the jury for their consideration and verdict. Thereafter, the jury unanimously rendered its verdict finding the defendants, Hyman Howard Goodman and Elwood L. Keeler, and each of them, guilty as charged in the indictment.

On December 3, 1941, the court sentenced the defendant Goodman to two years in a Federal Penitentiary and fined him \$5,000. [103]

STIPULATION

It is hereby stipulated that the foregoing is a full and true Bill of Exceptions, that it contains all of the evidence and proceedings at the trial in this case, and that it may be settled and filed as such.

Dated at Los Angeles, California, January 6, 1942.

WM. FLEET PALMER,
United States Attorney,
By LEO V. SILVERSTEIN,
Assistant U. S. Attorney.
LEO GOODMAN &
M. SEATON COHEN,
By M. SEATON COHEN,
Attorneys for defendant,
Hyman Howard Goodman.

ORDER
SETTLING BILL OF EXCEPTIONS

The foregoing is a full and true Bill of Exceptions in this case and contains all of the evidence and proceedings at the trial and it is hereby settled as such by the undersigned United States District Judge who presided at the trial, within the time allowed by law, as extended by the court within the time allowed by law.

Dated at Los Angeles, California; January 7, 1942.

BEN HARRISON,
United States District Judge.

[Endorsed]: Filed Jan. 7, 1942. R. S. Zimmerman, Clerk. By Murray E. Wire, Deputy Clerk.

[Title of District Court and Cause.]

ASSIGNMENT OF ERRORS OF DEFENDANT
HYMAN HOWARD GOODMAN

Defendant Hyman Howard Goodman alleges, in connection with his appeal, that the following prejudicial errors were committed in the proceedings in this case in the District Court and he therefore sets forth the following assignment of errors:

1st Error:

The facts and matters alleged in the indictment do not constitute any offense by the defendant Goodman against the laws of the United States and the District Court therefore erred in [105] entering judgment against and pronouncing sentence upon the said defendant.

2nd Error:

At the end of the Government's case the following took place (Bill of Exceptions, pp.48-49):

“Mr. Silverstein: The Govrenment rests.”

* * * * *

“Mr. Peterson: The Defendant Keeler now moves, at the close of the Government's case in chief, that the Court instruct the jury to return a verdict of not guilty against the Defendant Keeler, as charged in the indictment, on the ground they have not sufficient evidence to warrant the case going to the jury.

Mr. Cohen: The defendant Goodman interposes the same motion.

The Court: Motion denied.

Mr. Peterson: Exception allowed to each defendant?

The Court: Exception allowed to each defendant."

This motion by the defendant Goodman should have been granted and its denial by the District Court was erroneous for the reason that there was not sufficient evidence to warrant sending the case to the jury or to support a verdict of guilty or to show that the defendant Goodman committed the offense charged against him in the indictment.

3rd Error:

At the conclusion of the testimony the following took place (Bill of Exceptions, p. 71):

"Mr. Cohen: That is our case. Defendant Goodman rests.

Mr. Silverstein: No rebuttal. Government rests." [106]

"Mr. Cohen: Defendant Goodman, if your Honor please, also moves for a directed verdict on the grounds and for the reason that the Government has failed to prove any of the elements constituting the crime of conspiracy or a violation of the Executive order of the President as of the date of July 2, 1940; for that reason, the directed verdict should be given the Defendant Goodman.

The Court: Motion denied; exception noted."

This motion by the defendant Goodman for a directed verdict should have been granted and its denial by the District Court was erroneous for the reasons that the Government failed to prove the elements constituting the crime charged in the indictment and the evidence was insufficient to warrant sending the case to the jury.

4th Error:

During the examination of the witness Nakauchi for the Government the following took place (Bill of Exceptions, pp. 24-26):

“Examination by Mr. Silverstein:

“Q. Other than that, have you ever received any other diamonds? A. Yes, once.

Q. From whom?

A. I think either Mr. Takahashi or Mr. Takizawa.

Q. And when was that?

A. The end of July, I think.

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“Q. What did you do with them?

A. I at one time had in my hand a bag or something [107] that contained diamonds.

Q. What did you do with them after you received them?

A. I left them in a certain room in a hotel in San Francisco.

Q. You did that yourself? A. Yes.

The Court: Who gave you the diamonds?

The Witness: I think I received them from Mr. Takizawa.

The Court: Did you take them to San Francisco?

The Witness: My friend was returning to Japan and I chauffeured him up there.

By Mr. Silverstein:

Q. You chauffeured somebody that was going back to Japan? A. Yes.

Q. You drove somebody up north, is that it? A. Yes.

The Court: You took the diamonds with you?

The Witness: I do not know whether I had the diamonds or not, but I understood—I heard that the diamonds were in that bag.

Mr. Peterson: That, of course, ought to be stricken.

The Court: Just a moment. I will find out. What bag?

The Witness: A portable phonograph.

The Court: Who told you there were diamonds in there?

The Witness: Mr. Takizawa.

The Court: Is that one of the defendants in this case?

The Witness: The man that testified here before me.

Mr. Peterson: I now move to strike the testimony relative to the San Francisco episode upon the grounds that it has nothing to do with any of the issues in [108] this case, entirely outside of the scope of this indictment; it is hear-

say as against the defendant whom I represent.

The Court: It is a statement by a co-defendant. He said the satchel or bag contained industrial diamonds, and he took them to San Francisco.

Mr. Peterson: My recollection of his testimony is that he was told that they contained it.

The Court: He said one of the defendants told him. That would be binding, if there is a conspiracy.

Mr. Peterson: If it was within the scope of the indictment.

The Court: Objection overruled.

Mr. Peterson: Note an exception. May it be understood that if one of us makes an objection, it may be deemed by the other counsel."

The admission of the testimony of the witness Nakauchi, herein quoted, as to the facts that the bag or portable phonograph contained diamonds and that the defendant Takizawa told him that there were diamonds in the bag, and the refusal to strike the testimony were erroneous for the reason that the testimony was hearsay and inadmissible.

5th Error:

During the closing argument on behalf of the Government the following took place (Bill of Exceptions, pp. 71-73):

"Now let me say to you, this is a conspiracy charge, and if these defendants, or either of them, knew that the Japanese were purchasing these diamonds for export purposes, and they

aided and abetted, they are guilty under the law with knowledge of the conspiracy, if we show that beyond a reasonable doubt, [109] because they don't have to take active part; if they do anything in furtherance of the object of that conspiracy, with knowledge of it, under the law they are a party to it, they are a partnership, they are an agent for one another; and if these Japanese took these diamonds, and there is evidence before you that Takizawa went up to San Francisco in an automobile with another Japanese who was leaving for Japan—I don't know whether those diamonds went aboard the boat; I say that you have a right to infer that they did; that they went aboard one of the Japanese boats to get over to Japan—I say the evidence would give you the right to infer, after considering all of the evidence together, that that is just what took place, and that is what would have taken place on the other diamonds if they could have gotten away with it because there are ways that you know of to smuggle out of the United States.

Mr. Peterson: I want to take an exception to Mr. Silverstein's statement that the Japanese was going to San Francisco and then to Japan.

Mr. Silverstein: I didn't say that. I say there was a Japanese that was going to Japan.

The Court: The Court recalls testimony where Takizawa—I think that is the way you

pronounce it—went to San Francisco with another Japanese who was leaving for Japan; and one of the witnesses anyhow testified that he took this Japanese friend that was going to Japan, took the diamonds to San Francisco, and the last time he saw them was in a hotel room. [110]

Mr. Silverstein: That was Nakauchi, not Takizawa; I was wrong about the name.

So, therefore, some of the diamonds undoubtedly reached over there because letters came back to Takahashi concerning the quality, and you have a right, I believe, to infer that, from the facts we have shown you here, that logically, reasonably and honestly, and in all fairness to the defendant, you should conclude that they did reach there because of what came back and the conversations that Takahashi had with these defendants concerning the quality of the diamonds.”

The statement by Mr. Silverstein that Takizawa went to San Francisco with another Japanese who was leaving for Japan and the statement by the Court that there was testimony that Takizawa went to San Francisco with another Japanese who was leaving for Japan and that there was testimony by one of the witnesses that he took this friend that was going to Japan, took the diamonds to San Francisco, and the last time he saw them was in a hotel room, were erroneous for the reasons that there was no admissible testimony as to such facts and that the only testimony in the record upon

which such statements could be based was the testimony by Nakauchi, which is quoted in the 4th error of these assignments, and which testimony was inadmissible and should have been stricken.

6th Error

Section 99, Title 50, United States Code, and Presidential Proclamation of July 2, 1940 are and each of them is unconstitutional for the reason that they constitute an invalid delegation of the legislative power of Congress to, and an invalid exercise of such power by, the executive branch of the Government. For that reason there could be no conspiracy to violate the said section and Proclamation and the District Court [111] therefore erred in entering judgment against and pronouncing sentence upon the defendant Goodman.

Wherefore, the defendant Hyman Howard Goodman, respectfully asks that the judgment and sentence appealed from be reversed and the indictment dismissed against him.

Dated Los Angeles, California this 7th day of January, 1942.

HYMAN HOWARD GOODMAN,
Defendant.

M. SEATON COHEN &
LEO GOODMAN,

By LEO GOODMAN,
Attorneys for Defendant
Hyman Howard Goodman.

[Endorsed]: Filed Jan. 7, 1942. R. S. Zimmerman, Clerk. By Edmund L. Smith, Deputy. [112]

[Endorsed]: No. 9989. United States Circuit Court of Appeals for the Ninth Circuit. Hyman Howard Goodman, Appellant, vs. United States of America, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Filed January 31, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit.

No. 9989

HYMAN HOWARD GOODMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

STATEMENT OF POINTS AND DESIGNA-
TION OF PARTS OF RECORD NECES-
SARY FOR THE CONSIDERATION
THEREOF.

The Appellant, Hyman Howard Goodman, hereby
states that the points upon which he will rely on

this appeal will be the same as the Assignment of Errors heretofore filed herein.

The Appellant hereby designates the following documents to be included in the printed transcript of record:

1. Indictment
2. Arraignment and Plea
3. Verdict
4. Sentence and Judgment
5. Notice of Appeal (includes Grounds of Appeal)
6. Bond on Appeal
7. Order extending the time to file Bill of Exceptions
8. Bill of Exceptions with Order of Approval
9. Assignment of Errors.

Dated: January 27th, 1942.

LEO GOODMAN &
M. SEATON COHEN,
By LEO GOODMAN,
Attorneys for Appellant.

[113]

Rec'd Copy of within Statement this January 28,
1942.

WM. FLEET PALMER,
U. S. Atty.

[Endorsed]: Filed Jan. 31, 1942. Paul P.
O'Brien, Clerk.

No. 9989

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

HYMAN HOWARD GOODMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S BRIEF.

LEO GOODMAN,

M. SEATON COHEN,

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MAX BERGMAN,

Of Counsel.

FILED

MAR 20 1942

PAUL P. O'BRIEN.

TOPICAL INDEX.

	PAGE
Statement of the case.....	2
Specifications of errors.....	12
Second assignment of error.....	12
Third assignment of error.....	13
Argument	14
Point I. The evidence fails to show that any crime was committed. It shows at most that diamonds were purchased for the purpose of exportation to Japan, but there is no evidence (1) that there was a conspiracy to export them without a license, (2) that any of the diamonds were actually exported, or (3) if they were exported—that the person who exported them had no license.....	14
(a) Nakauchi's testimony about the San Francisco trip.....	20
(b) Takahashi's testimony about the letters from Japan.....	26
Point II. Goodman's acts in supplying the diamonds, being of themselves lawful, did not become criminal even if any of the other defendants thereafter unlawfully exported the diamonds without a license.....	30
The court erred in the denial of the motion to strike out the testimony by the defendant Nakauchi that the defendant Takizawa had told him that there were diamonds in a package which he took to San Francisco. The reference to that testimony during the Government's closing argument, both by the trial court and the United States Attorney, accentuated the error and caused substantial harm to the appellant.....	33
Conclusion	35
Appendices :	
Appendix I. United States v. Falcone, 311 U. S. 205.....	37
Appendix II. Fourth assignment of error.....	41
Fifth assignment of error.....	43

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Bartkus v. United States, 7th Cir., 21 F. (2d) 425.....	25
Brown v. United States, 1st Cir., 16 F. (2d) 682.....	23
Dahly v. United States, 8th Cir., 40 F. (2d) 37.....	23
Kennedy v. United States, 44 F. (2d) 131.....	18, 23
Lynch v. Oregon Lumber Co., 9th Cir., 108 F. (2d) 283.....	34
Marino v. United States, 9th Cir., 91 F. (2d) 691, 113 A. L. R. 975, cert. den. 302 U. S. 764.....	14, 30
Mayola v. United States, 9th Cir., 71 F. (2d) 65.....	24
McCandles v. United States, 298 U. S. 342.....	34
Oras v. United States, 9th Cir., 67 F. (2d) 463.....	24, 34
Pattis v. United States, 9th Cir., 17 F. (2d) 562.....	31
Poole v. United States, 9th Cir., 97 F. (2d) 423.....	34
Shillitani v. United States, 2 Cir., 279 F. 393.....	18
Tofanelli v. United States, 9th Cir., 28 F. (2d) 581.....	25
United States v. Falcone, 311 U. S. 205, affirming 109 F. (2d) 579	31
United States v. Mann, 7th Cir., 108 F. (2d) 354.....	19
United States v. Ross, 92 U. S. 281.....	23
Young v. United States, 5th Cir., 48 F. (2d) 26.....	31, 32

MISCELLANEOUS.

Presidential Proclamation (No. 2413).....	1, 15
---	-------

STATUTES.

Judiciary Code, Sec. 24 (28 U. S. C. A., Sec. 41).....	2
Judiciary Code, Sec. 128 (28 U. S. C. A., Sec. 225).....	2
United States Code Annotated, Title 18, Sec. 88.....	1
United States Code Annotated, Title 50, Sec. 99	1, 14

No. 9989

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HYMAN HOWARD GOODMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S BRIEF.

Jurisdiction.

This appeal is from a judgment of conviction [R. 7-8] entered on December 1, 1941, in the District Court of the United States for the Southern District of California, Central Division, after a trial before Judge Ben Harrison and a jury.

The indictment [R. 2-5] was filed on October 22, 1941. It contained one count and charged the appellant and five others, Kichiro Takizawa, George M. Nakauchi, Kenkichi Takahashi, Elwood L. Keeler and Hiroshi Yamaguchi, with a conspiracy (18 U. S. C. A. §88) to export industrial diamonds from the United States to Japan without a license, in violation of 50 U. S. C. A. §99 and the Presidential Proclamation of July 2, 1941.

The defendants Takizawa, Nakauchi and Takahashi pleaded guilty. The indictment against the defendant Yamaguchi was dismissed upon motion by the Government. The appellant and the defendant Keeler were tried and found guilty. [R. 6-7, 18-19.]

Appellant's notice of appeal was filed on December 3, 1941. [R. 9-12.] The bill of exceptions [R. 18-132] and assignment of errors [R. 133-140] were filed on January 7, 1942, within the time allowed by law, as extended by order of the District Court. [R. 16-17.]

The jurisdiction of the District Court was based on section 24, Judiciary Code (28 U. S. C. A. §41). The jurisdiction of this court is invoked under section 128, Judiciary Code (28 U. S. C. A. §225).

Statement of the Case.

The principal ground urged by the appellant for a reversal herein is that the proof was insufficient to sustain the verdict. We therefore present at the outset a summary of the evidence, chronologically arranged. In consonance with the principle that an appellate court views the evidence in a light most favorable to the appellee, we have analyzed the evidence upon the assumption that all conflicts and questions of fact have been resolved by the jury in favor of the Government. The summary is as follows:

Goodman, the appellant, is a native citizen of the United States who has lived in California since 1919. He was engaged in the import-export business for a number of years. [R. 67, 99.]

The defendant Takahashi is a Japanese who had been travelling between the United States and Japan since

1907, in connection with his business of importing and exporting various articles of merchandise between the two countries. He returned from his last trip to Japan in May, 1941. [R. 34, 38.]

Goodman and Takahashi first met in 1937. Since then they had several business transactions with each other in connection with Takahashi's export business. [R. 35, 99, 106, 109.]

In June, 1941 Takahashi told Goodman that he was going into business here and wanted to purchase a number of articles. He gave Goodman a list of articles which he was going to handle, including industrial diamonds, machinery and old stockings. Takahashi further told Goodman that he had an order from Japan for industrial diamonds and if he were able to fill that order he wanted to purchase them. Goodman answered that Takahashi would be able to purchase the diamonds through him. Takahashi asked Goodman to obtain an export license and Goodman said he would try. They then arranged that Goodman would receive from Takahashi 10% commissions on all purchases of industrial diamonds. [R. 20-22, 25, 34, 37-38.]

Goodman then looked for suppliers of industrial diamonds and found Musto-Keenan Co. listed in the telephone directory. [R. 87, 100.]

Musto-Keenan Co. have been a dealer in industrial diamonds in Los Angeles for a number of years. The defendant Keeler was its secretary-treasurer and the manager of the abrasives department, which included industrial diamonds. Keeler received a weekly salary and 25% of the annual profits realized by the abrasives department. [R. 40-41, 85.]

After a telephone appointment, Goodman went to the office of Musto-Keenan Co. where Keeler and he met for the first time. Goodman told Keeler that he had a customer, Takahashi, for industrial diamonds for whom he was acting as broker. Keeler said that Musto-Keenan Co. would be able to sell the diamonds. Goodman then told Keeler that he would get a commission from Takahashi on the purchases, but that on previous occasions when he had purchased merchandise for Takahashi, the latter had reduced Goodman's commission when he found out the source of supply and refused to pay him the full commissions originally agreed upon. Goodman therefore asked for an extra commission from Musto-Keenan Co. Keeler said that Musto-Keenan Co. did not pay commissions, but that when there was a broker in a deal there could be a differential of about 4 or 5% between the actual selling price and the list price to the customer which would be retained by the broker. [R. 87, 101, 109-110.]

Keeler and Goodman then arranged that on sales to Takahashi two invoices would be issued by Musto-Keenan Co. One invoice would state the list price and the other would state the net price, which was 5% less. The larger invoice would be given to Takahashi, who would pay accordingly, and Musto-Keenan Co. would then refund to Goodman the extra 5% as his commissions. [R. 57-59, 65, 87, 89, 101.]

Goodman then purchased some samples of industrial diamonds for \$13.21, for which he paid in cash and delivered them to Takahashi. These samples are in evidence as Exhibit 2. [R. 23, 25.]

Takahashi was dissatisfied with the quality and color of the samples and Takahashi and Goodman therefore

decided to go together to Musto-Keenan Co. About the end of June, 1941 Goodman and Takahashi went to Musto-Keenan Co., where Takahashi and Keeler had a conversation in Goodman's presence. Takahashi told Keeler that he wanted to purchase industrial diamonds. Keeler asked for what purpose Takahashi was going to use them. Takahashi said that he had received an order from Japan for the diamonds but that he knew nothing about diamonds. He was therefore going to trust Keeler entirely. Keeler answered that Takahashi would not have to be afraid of losing money on anything he, Keeler, would handle. [R. 23-24, 101-102.]

As the end of the conversation Takahashi gave an order for some representative samples of diamonds. Keeler ordered the diamonds from New York and delivered them in Los Angeles about July 7, 1941. This was the first sale to Takahashi. [R. 39, 88.]

Between July 7 and October 1, 1941, there were six sales of industrial diamonds by Musto-Keenan Co. which were delivered to Takahashi in Goodman's presence. The volume of these sales was larger than to any other customer of Musto-Keenan Co. [R. 39, 94, 95.]

Following is a summary of these sales, as reflected in the sales book [Exhibits 10 and 11, R. 39]:

Order No.	Date	Sold to	Item	Price	Sale Tax	Total Price
A 1265	6/30/41	Cash	Bortz & 10.95 cts. Diamonds	\$ 13.21	\$.40	\$ 13.61
A 1267	7/ 7/41	H. H. Goodman	Misc. Bortz	354.16	10.63	364.79
A 1275	7/22/41	"	Bortz	5136.97	154.11	5291.08
A 1280	8/ 1/41	"	Misc. Bortz	1570.00	46.10	1677.10
A 1287	8/11/41	"	"	2210.11	66.30	2276.41
A 1298	9/ 4/41	"	700 cts. lot 11/3's diamonds	3731.00	111.93	3842.93
A 1312	10/ 1/41	"	Misc. Bortz	8115.29	243.46	8358.75

During this period Takahashi saw Keeler in Goodman's presence at Musto-Keenan Co. office about 10 times. He always discussed the quality of the diamonds with Keeler and Goodman. He told them that he had received letters from Japan in which they demanded extra good quality and that, although he was not experienced in diamonds, he did not think the quality of the diamonds was very good. [R. 30-31, 33, 35-37.]

Upon each sale Keeler made out two bills, one stated the list price and the other the net price, which was less 5%. The bill for the list price was given to Takahashi, who did not know about the other bill. Takahashi paid Goodman the list price and Goodman paid the same amount to Keeler in Takahashi's presence. Subsequently Keeler refunded to Goodman the extra 5% and retained for Musto-Keenan Co. only the net price. The total commissions which Goodman received from Musto-Keenan Co. as a result of these refunds was about \$800. [R. 25, 33, 37-38, 57-59, 65-66, 89, 103, 104.]

As anticipated by Goodman, although Takahashi originally agreed to pay Goodman a commission of 10% on all purchases, he subsequently reduced the commission to 5%, and made Goodman agree to rebate 2% to him. This left Goodman a net of only 3%. Moreover, Takahashi failed to pay Goodman even this reduced commission and actually paid him a total of only \$268.15. Goodman believed that Takahashi had a large yen fund on which he could raise American dollars to purchase industrial diamonds and other things and that the source of some of Takahashi's dollars was the receipt of dollars from people in the United States in exchange for yen in Japan. Takahashi told Goodman "I cannot pay for diamonds

until the ship gets in" and "I will pay you your commissions when the boat arrives". But he never paid more than the \$268.15. [R. 25, 38, 66-67, 105, 107-108, 113-114.]

Goodman generally paid Musto-Keenan Co. with his own checks [Exhibits 12, 13 and 14]. Takahashi paid Goodman by cash and checks on California banks. Two of these checks in evidence were made by Takahashi and two others by Takizawa. Takahashi's checks were returned uncollected by the bank and were afterwards made good. [Exhibits 3, 16 and 17; R. 43-44, 48-49, 103.]

Sometime in July and after Takahashi had made one or two purchases, Takizawa came to Keeler, showed him a copy of the list which Keeler had previously given to Goodman and asked Keeler about prices for industrial diamonds. Keeler told Takizawa that other people, including Takahashi, were placing orders for diamonds and asked "Who brought up this list?" But Takizawa did not reply. Keeler then said that if Takizawa was going to purchase together with Takahashi it would be all right and that it would be very dangerous if Takizawa did not purchase the diamonds together with Takahashi. [R. 45-46, 94.]

When Keeler next saw Takahashi and Goodman he told them about Takizawa's visits. Takahashi said that Takizawa was one of his associates. Keeler then said that he would prefer that Takahashi and Takizawa purchased material together and credited Goodman with the sales, so that there would be no friction between the two. [R. 103.]

In August Takizawa met Takahashi, Goodman and Keeler at Musto-Keenan Co.'s office and there was a

conversation about diamonds. Takahashi complained that the quality of the diamonds was not very good. Keeler answered that it was the best for the price. Takahashi then said that there was a big order coming from Japan and he wanted Keeler to be very careful about the quality. Keeler answered that it would be all right. Takahashi placed an order for diamonds for about \$15,000, but insisted that Keeler personally go East to select the quality. Keeler agreed to take the trip only after Takahashi put up a deposit of \$1000 and promised to take the entire lot when it arrived. [R. 46-47, 89-90.]

Keeler then went to Chicago, selected the diamonds and had them shipped to Musto-Keenan Co.'s bank at Los Angeles. Upon Keeler's return he showed the diamonds to Takahashi and Takizawa in Goodman's presence, but only a part of the diamonds were then taken up. [R. 90.]

Keeler was about to leave with his wife for a vacation in Mexico and arranged with Goodman to meet him upon his return, to take up the balance of the diamonds. Keeler afterwards sent Goodman a card from Mexico notifying him of the time of his arrival. Upon Mr. and Mrs. Keeler's return on September 15, Takahashi and Goodman met them at the airport. There were conversations between Keeler, Takahashi and Goodman, and it was arranged that they would meet the following morning to take up the balance of the diamonds. [R. 31, 35, 68, 90-91, 104.]

The following morning Keeler took the diamonds from the vault in the bank and drove with Goodman to the latter's office, where Takahashi, Takizawa and Nakauchi subsequently arrived. After some conversations Takahashi took the balance of the diamonds, paid Goodman

about \$8000 and Goodman in turn gave Keeler a check for the same amount. Musto-Keenan Co. did not use this check, but returned it to Goodman a few days later in exchange for Goodman's check for the correct amount, after allowing Goodman 5% commission. [R. 31-32, 47-48, 91, 105.]

This was the last sale of diamonds by Musto-Kennan Co. and the last time when Goodman was in contact with the other defendants.

As stated, the foregoing resumé of the facts and of Goodman's dealings with Takahashi, Keeler and the other defendants is based upon all of the evidence, viewed from a light most favorable to the Government. The only conflict in the testimony was that Goodman and Keeler denied that Takahashi had told them that he was buying the diamonds for export to Japan and that Takahashi had asked Goodman to obtain a license, but under the principle that all facts are deemed to have been found in appellee's favor, it is assumed that the jury accepted Takahashi's testimony and our argument will proceed on that basis.

It was also conceded that none of the defendants named in the indictment had a license to export industrial diamonds from the United States. [R. 19.]

It is not contended and there is no testimony that Goodman had anything to do with the diamonds after they reached Takahashi's hands.

The only evidence with respect to the disposition of the diamonds purchased from Musto-Keenan Co. is as follows:

The sample diamonds purchased by Goodman at his first meeting with Keeler were kept by Takahashi. They are in evidence as Exhibit 2. Takahashi returned some of the other diamonds to Musto-Keenan Co. and received credit, but he testified that he did not send any of them away. [R. 25, 30.]

There is no testimony by Takizawa that he received or disposed of any diamonds.

Nakauchi testified that on one occasion he received diamonds from Takahashi but returned them immediately because the quality was bad. Takahashi told him that he was going to have them exchanged. [R. 51.]

On another occasion Nakauchi received three packages of diamonds from Takahashi or Takizawa and put them on a shelf in his store in Gardena. These three packages were taken from that shelf by Mr. McCormick, the agent of the Federal Bureau of Investigation, and are in evidence as Exhibit 9. [R. 51, 59.]

Despite a motion to strike, the court permitted Nakauchi to testify that Takahashi or Takizawa once gave him a bag or portable photograph and told him that it contained diamonds and that Nakauchi left the package in a hotel room in San Francisco. He had driven to San Francisco with a friend who was returning to Japan. [R. 52-54.]

There was no testimony that Goodman or Keeler were ever told or knew anything about this trip to San Francisco or the conversation between Takizawa and Nakauchi. Furthermore, there was no evidence that the package actually contained diamonds, that Nakauchi's friend actually went to or took diamonds to Japan, or if he did take diamonds, that he had no license to export them.

The defendants made a motion to strike out this testimony about the San Francisco incident, but the motion was denied and an exception taken. [R. 53-54.]

During the argument, the Government referred to this testimony by Nakauchi and told the jury that they had a right to infer that diamonds were taken to San Francisco and that they "went aboard one of the Japanese boats to get over to Japan". Exception was taken to this statement, but the trial court stated that "one of the witnesses anyhow testified that he took this Japanese friend that was going to Japan, took the diamonds to San Francisco, and the last time he saw them was in a hotel room". [R. 116-117.]

At the conclusion of the Government's case and of the entire case the defendants made motions for a directed verdict on the ground that there was not sufficient evidence to warrant sending the case to the jury and that the Government failed to prove the elements of a conspiracy or a violation of the Presidential Proclamation of July 2, 1940. Both motions were denied and exceptions taken. [R. 84-85, 115-116.]

Specification of Errors.

Appellant relies upon the second [R. 133-134], third [R. 134-135], fourth [R. 135-137] and fifth [R. 137-140] assignments of error.

The second and third assignments involve one question—the sufficient^{cy} of the evidence—and will be argued together. The fourth and fifth assignments likewise involve one question—admission of testimony—and will be argued together.

Second Assignment of Error.

[R. 133-134.]

“At the end of the Government’s case the following took place:

“Mr. Silverstein: The Government rests.”

* * * * *

“Mr. Peterson: The Defendant Keeler now moves, at the close of the Government’s case in chief, that the Court instruct the jury to return a verdict of not guilty against the Defendant Keeler, as charged in the indictment, on the ground that they have not sufficient evidence to warrant the case going to the jury.

Mr. Cohen: The defendant Goodman interposes the same motion.

The Court: Motion denied.

Mr. Peterson: Exception allowed to each defendant?

The Court: Exception allowed to each defendant.”

This motion by the defendant Goodman should have been granted and its denial by the District Court was erroneous for the reason that there was not sufficient evidence to warrant sending the case to the jury or to support a verdict of guilty or to show that the defendant Goodman committed the offense charged against him in the indictment.”

Third Assignment of Error.

[R. 134-135.]

“At the conclusion of the testimony the following took place:

“Mr. Cohen: That is our case. Defendant Goodman rests.

Mr. Silverstein: No rebuttal. Government rests.

Mr. Cohen: Defendant Goodman, if Your Honor please, also moves for a directed verdict on the grounds and for the reason that the Government has failed to prove any of the elements constituting the crime of conspiracy or a violation of the Executive order of the President as of the date of July 2, 1940; for that reason, the directed verdict should be given the Defendant Goodman.

The Court: Motion denied; exception noted.”

This motion by the defendant Goodman for a directed verdict should have been granted and its denial by the District Court was erroneous for the reason that the Government failed to prove the elements constituting the crime charged in the indictment and the evidence was insufficient to warrant sending the case to the jury.”

ARGUMENT.

POINT I.

The Evidence Fails to Show That Any Crime Was Committed. It Shows at Most That Diamonds Were Purchased for the Purpose of Exportation to Japan, but There Is No Evidence (1) That There Was a Conspiracy to Export Them Without a License, (2) That Any of the Diamonds Were Actually Exported, or (3) if They Were Exported —That the Person Who Exported Them Had No License.

This being a conspiracy case it was incumbent upon the Government to prove that there was herein

“* * * a combination of two or more persons, by concerted action, to accomplish a criminal or unlawful purpose, or some purpose not in itself criminal or unlawful, by criminal or unlawful means.”

Marino v. U. S., 9 Cir., 91 F. (2d) 691, 693; 113 A. L. R. 975; cert. den. 302 U. S. 764.

We submit that an analysis of the evidence in the light of the applicable authorities fails to reveal any legal proof of the existence of such a conspiracy.

Section 99, Title 50, U. S. C. A., which is the basis of the charge in this case, was enacted on July 2, 1940. Its pertinent provisions are as follows:

“Whenever the President determines that it is necessary in the interest of national defense to prohibit or curtail the exportation of any military equipment or munitions, or component parts, thereof, or machinery, tools, or material, or supplies necessary for the manufacture, servicing, or operation thereof, he

may by proclamation prohibit or curtail such exportation, except under such rules and regulations as he shall prescribe."

On the same day the President took the following action under the statute: (1) He issued a Military Order designating Brigadier General Russell L. Maxwell as Administrator of Export Control, and (2) he issued a Presidential Proclamation (No. 2413) providing, among other things as follows:

"NOW, THEREFORE, I, FRANKLIN D. ROOSEVELT, President of the United States of America, acting under and by virtue of the authority vested in me by the said act of Congress, do hereby proclaim that the administration of the provisions of section 6 of that act is vested in the Administrator of Export Control, who shall administer such provisions under such rules and regulations as I shall from time to time prescribe in the interest of the national defense.

"AND I do hereby further proclaim that upon the recommendation of the aforesaid Administrator of Export Control, I have determined that it is necessary in the interest of the national defense that on and after July 5, 1940, the articles and materials hereinafter listed shall not be exported from the United States except when authorized in each case by a license as hereinafter provided: * * *

"i. Industrial diamonds. * * *

"AND I do hereby empower the Secretary of State to issue licenses authorizing the exportation of any of the said articles and materials the exportation of

which is not already subjected to the requirement that a license be obtained from the Secretary of State authorizing their exportation and I do hereby authorize and enjoin him to issue or refuse to issue licenses authorizing the exportation of any of the articles or materials listed above in accordance with the aforesaid rules and regulations or such specific directives as may be, from time to time, communicated to him by the Administrator of Export Control."

Although the statute authorized the President to "prohibit or curtail" exportation, he did not completely prohibit the exportation of industrial diamonds but merely prohibited such exportation *without a license*.

On March 15, 1941, the President issued an executive order, effective April 15, 1941, prescribing additional regulations governing the exportation of articles enumerated in the Proclamation of July 2, 1940. Among these regulations is the following:

"8. The original license must be presented, prior to exportation, to the collector of customs at the port through which the shipment authorized to be exported is being made. If shipment is made by parcel post, the license must be presented to the postmaster at the post office at which the parcel is mailed."

The Administrator of Export Control at the same time issued the following "Information Regarding the Exportation of Articles and Material Subject to License" (pp. 25-32 of "Export Control Regulations and Export

Control Schedule No. 1" published by the Administrator of Export Control, effective April 15, 1941):

"4. WHO MAY APPLY.

- a. Applications may be made by a corporation, partnership, individual, or their duly authorized agent, who is in fact the exporter of the goods, except when the proposed shipment consists of unusual metal working machinery, in which case applications must be made by the manufacturer * * *

"5. WHEN TO APPLY,

- a. Applications may be made at any time prior to the clearing of the goods through the port of exit."

It thus appears that there was no requirement that a person who purchased industrial diamonds for exportation purposes had to obtain a license. A license was only necessary "prior to exportation" and had to be obtained by the person "who is in fact the exporter of the goods" and "at any time prior to the clearing of the goods through the port of exit".

Due to the recent origin of the statute and Proclamation we have not found any reported judicial decision defining the quantum of proof necessary in prosecutions for their violation. However, the Proclamation closely parallels the law which prohibits the importation of goods without payment of customs duties. In both cases the acts of exportation and importation are not prohibited absolutely, but only conditionally, *i. e.*, exportation without a license and importation without declaration and payment of duties. The law thus recognizes both lawful and unlawful exportations and importations.

There have been many decisions defining the proof necessary for conviction in smuggling cases. Some of these are collected in 25 C. J. Secundum, recently published, at page 399, in support of the following rule:

“* * * and the government has the burden of showing that the merchandise was imported into the country from without and that it was unlawfully imported.”

In *Kennedy v. U. S.*, 44 F. (2d) 131, 133, a smuggling case, this court said:

“The burden of unlawful importation is on the government.”

In *Shillitani v. U. S.*, 2 Cir., 279 F. 393, a case involving a conspiracy to smuggle, the court reversed a conviction although there was no question that the defendant knew that the goods had been imported from abroad, and said (p. 395):

“There was no evidence whatever to sustain either of the counts of the indictment, no showing that the goods had been introduced into the United States contrary to law, and consequently no showing that the defendant had any knowledge of unlawful importation or failure to pay duty.”

By a parity of reasoning, it must follow that it is necessary for the Government in a case of this type to furnish proof not only that there was a combination to export the diamonds, but also that Goodman participated in a conspiracy to export them unlawfully or without obtaining a license “prior to exportation”.

Is there any proof, direct or circumstantial, that anyone involved in this case violated or conspired to violate the above license regulations?

All that the evidence shows is that Takahashi and Takizawa were purchasing and Keeler and Goodman were selling industrial diamonds intended for export to Japan and that they had no export licenses. But that is as far as the evidence goes.

The most vital link in the chain of incriminating evidence—that the diamonds were to be exported or were actually exported *without a license*—is missing.

It is true that Takahashi, Takizawa and Nakauchi pleaded guilty, but their admissions of guilt can, of course, in no way affect Goodman, whose

“* * * guilt and sentence are not to be determined by the court’s or jury’s estimate, false or sound, of a confederate’s character or by the extent of a conspirator’s guilty participation in the substantive offense.”

U. S. v. Mann, 7 Cir., 108 F. (2d) 354, 356.

In the court below the Government argued [R. 116-118] that the jury could infer from the following items of evidence that the diamonds were actually exported to Japan: (a) The testimony by Nakauchi about his trip to San Francisco, and (b) the testimony by Takahashi about the letters that he received from Japan. We anticipate that the Government will similarly rely upon that evidence to sustain its position before this court and therefore will analyze both items closely.

(a) NAKAUCHI'S TESTIMONY ABOUT THE
SAN FRANCISCO TRIP.

Nakauchi's testimony was as follows [R. 52-55]:

“Q. Other than that, have you ever received any other diamonds? A. Yes, once.

Q. From whom? A. I think either Mr. Takahashi or Mr. Takizawa.

Q. And when was that? A. The end of July, I think.

* * * * *

Q. What did you do with them? A. I at one time had in my hand a bag or something that contained diamonds.

Q. What did you do with them after you received them? A. I left them in a certain room in a hotel in San Francisco.

Q. You did that yourself? A. Yes.

The Court: Who gave you the diamonds?

The Witness: I think I received them from Mr. Takizawa.

The Court: Did you take them to San Francisco?

The Witness: My friend was returning to Japan and I chauffeured him up there.

By Mr. Silverstein:

Q. You chauffeured somebody that was going back to Japan? A. Yes.

Q. You drove somebody up north, is that it? A. Yes.

The Court: You took the diamonds with you?

The Witness: I do not know whether I had the diamonds or not, but I understood—I heard that the diamonds were in that bag.

Mr. Peterson: That, of course, ought to be stricken.

The Court: Just a moment, I will find out. What bag?

The Witness: A portable phonograph.

The Court: Who told you there were diamonds in there?

The Witness: Mr. Takizawa.

The Court: Is that one of the defendants in this case?

The Witness: The man that testified here before me.

Mr. Peterson: I now move to strike the testimony relative to the San Francisco episode upon the grounds that it has nothing to do with any of the issues in this case, entirely outside of the scope of this indictment; it is hearsay as against the defendant whom I represent.

The Court: It is a statement by a co-defendant. He said the satchel or bag contained industrial diamonds, and he took them to San Francisco.

Mr. Peterson: My recollection of his testimony is that he was told that they contained it.

The Court: He said one of the defendants told him. That would be binding, if there is a conspiracy.

Mr. Peterson: If it was within the scope of the indictment:

The Court: Objection overruled.

Mr. Peterson: Note an exception. May it be understood that if one of us makes an objection, it may be deemed by the other counsel."

Assuming that this evidence be deemed properly admissible and binding on Goodman (which we question and will presently discuss), it is entirely innocuous and does not give rise to any inference that there was a conspiracy to export the diamonds unlawfully or that the diamonds were actually exported without a license.

All we are told is that Takizawa gave Nakauchi a package in which, according to what Takizawa told him, there were industrial diamonds and that Nakauchi left it in a hotel room in San Francisco. We are also told that on his trip to San Francisco Nakauchi drove up a friend who was returning to Japan.

Firstly, there is no evidence showing any connection between the friend in the automobile and the package in the hotel room. But even if, by a stretch of the imagination, the jury could have arrived at the conclusion that there was such a connection between Nakauchi's friend and the package in the hotel room, there is no evidence whatsoever (1) about the identity of the friend; (2) that this friend ever went to Japan; (3) that he ever took the package to Japan; (4) that he had no license to export diamonds, if he did actually export them.

For aught that we know—and it must be presumed—this friend, who would be “in fact the exporter” if he took the diamonds to Japan, had a license “prior to the clearing”, as required by the rules 4 and 5, quoted on page 17, *supra*.

It would therefore be pure conjecture to say that Nakauchi's testimony proves that the diamonds were at all exported or were exported without a license. Conjecture is not evidence.

A great deal has been written about circumstantial evidence and the extent to which inferences may be drawn from evidentiary facts. But the best guide is still the one laid down many years ago by the Supreme Court in *U. S. v. Ross*, 92 U. S. 281, 284, that:

“The law requires an open, visible connection between the principal and evidentiary facts and the deductions from them, and does not permit a decision to be made on remote inferences.”

Another principle frequently quoted and applied is that set forth in *Dahly v. U. S.*, 8 Cir., 40 F. (2d) 37, 43, as follows:

“Circumstantial evidence is equally available with direct evidence to prove the conspiracy, but suspicion or conjecture cannot take the place of evidence. Guilt must be established beyond a reasonable doubt, and, where the evidence is as consistent with innocence as with guilt, no conviction can properly be had.”

This court has expressed the same idea in *Kennedy v. U. S.*, 44 F. (2d) 131, as follows:

“Circumstantial evidence, of itself, is sufficient to convict if the circumstances are consistent with each other, consistent with the guilt of the party charged, inconsistent with his innocence and inconsistent with every other reasonable hypothesis except that of guilt.”

The entire subject was summed up tersely in *Brown v. U. S.*, 1 Cir., 16 F. (2d) 682, 685, as

“In a criminal case, where the liberty of a citizen is at stake, the jury should not rest its verdict upon conjecture or suspicion.”

When examined with these principles in mind, Nakauchi's testimony contains no fact from which the jury could properly infer the existence of a conspiracy that the diamonds would be exported or that they actually were exported without a license.

Moreover, this testimony by Nakauchi may not even be considered in determining Goodman's guilt.

There being no other or independent testimony that a conspiracy existed and that Goodman was a party to it, then this evidence by Nakauchi about his conversation with Takizawa and his trip to San Francisco, of which Goodman had no knowledge, was not admissible or binding upon Goodman.

As was said in *Mayola v. U. S.*, 9 Cir., 71 F. (2d) 65, 67:

“Before the declarations of co-conspirators can be received in evidence against one charged with participating in the conspiracy, it must be shown by independent evidence that the conspiracy existed and that the accused was a party to it at the time the declarations were made.”

Being thus pure hearsay, this evidence is of no value under the well-settled rule that:

“Reviewing court, in considering sufficiency of proof, should eliminate hearsay evidence.”

Oras v. U. S., 9 Cir., 67 F. (2d) 463 (syllabus, p. 464).

To the same effect is *Tofanelli v. U. S.*, 9 Cir., 28 F. (2d) 581.

A similar situation arose in *Bartkus v. U. S.*, 7 Cir., 21 F. (2d) 425. It was there charged that the defendants named Bartkus, Kelps, Nevar and Dronsuth, had conspired to conceal a bankrupt's property. The defendants were convicted and on appeal challenged the sufficiency of the evidence. There was evidence that Bartkus, together "with others" (who were not identified), took away property belonging to the bankrupt. In reversing, the court said (p. 428):

"But the evidence shows that Kelps, Nevar and Dronsuth were not 'the others' with Bartkus. No one of them was present or was known to have had any knowledge of it. As evidence that they conspired to do this particular thing, it has no probative force whatever. We are not now concerned with the question whether, if a conspiracy were proved, they would be bound by Bartkus' acts. If a conspiracy to conceal had otherwise been established, the act of Bartkus would be the act of all the conspirators. But the act of Bartkus, even if done in pursuance of a plan formed by him, if done without the participation and knowledge of Kelps, Neva and Dronsuth, do not tend to show that they participated in his plan.

The facts proved may warrant the conclusion that Bartkus planned to conceal the bankrupt's property as alleged, but they are not sufficient to support a verdict that Kelps, Nevar and Dronsuth participated with him in such plan. The verdict and judgments against Kelps, Nevar and Dronsuth cannot stand; * * *

(b) TAKAHASHI'S TESTIMONY ABOUT THE LETTERS
FROM JAPAN.

This testimony is of even less probative force than Nakauchi's testimony about the San Francisco incident. This testimony given during direct examination is as follows [R. 30-31]:

“Q. Did you ever have a conversation with Mr. Keeler about hearing from anyone in Japan regarding diamonds that had been sent? A. No, I did not.

The Witness: I discussed with Keeler the quality of the diamonds and told him I didn't think the quality of the first sample was very good. I spoke occasionally about the quality and that the price was very high.

Q. Did you say anything to him about anyone advising you as to the quality or the price? A. I told him that I had received letters quite a bit from Japan in which they referred quite a lot to the quality; I told him that.

Q. What did you tell him about those letters that you had received concerning the quality? A. The demand that was made by Japan was that they wanted extra good quality; and I told him, not being experienced, even though not being experienced in diamonds, I didn't think the quality was very good.

Q. Was anyone else present when you told Mr. Keeler that? A. Mr. Goodman was there, and Mr. Takizawa was there at times.”

And during cross-examination [R. 35-36]:

“Q. Now, then, you mentioned some letters from Japan. What letters did you get from Japan? A. I got all kinds of letters from Japan.

Q. Did you get any letters from Japan on industrial diamonds? A. Yes.

Q. When? How long ago? A. Also in July and August.

Q. They were written in Japanese to you, I suppose? A. Yes.

Q. You didn't show anything like that to Mr. Goodman, did you? A. No, I did not.

The Court: Did you tell him the contents of the letters?

The Witness: Yes.

The Court: What did you tell him?

By Mr. Cohen:

Q. What did you tell him about that? A. I told him that they referred to the quality.”

As stated, the Government argued that from this testimony the jury could infer that some of the diamonds reached Japan. [R. 117-118.] How such an inference can possibly be drawn is beyond comprehension.

The witness testified directly that all he told Keeler and Goodman was that he had received letters in which Japan wanted good quality diamonds, but that he did not tell them that he had heard from anyone in Japan regarding diamonds that had been sent. Takahashi spoke all

along about getting good quality and rejected some of the diamonds offered by Keeler because he did not like them. What connection is there between a mere demand for good quality, whether made by Takahashi's customer in Japan through the mail or by Takahashi orally, and the conclusion that Japan had already received some diamonds?

Furthermore, even if it be inferred from these letters that some diamonds had been exported, where is the inference that they were exported by any of the defendants, who were without licenses, in face of the testimony that they did not export any diamonds? In what manner do the letters prove that there was an unlawful exportation?

It follows that Nakauchi's testimony about the San Francisco incident and Takahashi's testimony about the letters from Japan furnish no incriminating proof against Goodman. The situation still remains the same, *i. e.*, that the chain of evidence shows only that the diamonds were intended for Japan, but the most important link—that they were to be exported or were exported *without a license*—is still missing.

As a matter of fact the case seems to have been tried, at least on the part of the Government, with the idea that Goodman was a criminal if he merely helped the Japanese to purchase diamonds for export purposes and without an attempt to show that the crime depended upon exportation without a license. This is evident from the following

statement made during the course of the Government's closing argument to the jury [R. 116]:

"Mr. Silverstein: Now let me say to you, this is a conspiracy charge, and if these defendants, or either of them, knew that the Japanese were purchasing these diamonds for export purposes, and they aided and abetted, they are guilty under the law knowledge of the conspiracy, if we show that beyond a reasonable doubt, because they don't have to take active part; if they do anything in furtherance of the object of that conspiracy, with knowledge of it, under the law they are a party to it, they are a partnership, they are an agent for one another; * * *"

The Government thus asked for a conviction based upon the fact that the defendants on trial (Goodman and Keeler) "knew that the Japanese were purchasing these diamonds for export purposes". According to the Government, it was immaterial whether Goodman knew that the exportation would be without a license.

We submit that that was exactly what the jury did or could have done, *i. e.*, Goodman was convicted as a conspirator solely because he sold diamonds intended for exportation purposes.

Thus the Presidential Proclamation which merely imposed the requirement of a license "prior to exportation", has in this case been virtually interpreted as an absolute prohibition of exportation, with the result that Goodman, a legitimate merchant, stands convicted for having sold a legitimate article for legitimate export purposes.

POINT II.

Goodman's Acts in Supplying the Diamonds, Being of Themselves Lawful, Did Not Become Criminal Even if Any of the Other Defendants Thereafter Unlawfully Exported the Diamonds Without a License.

So far in our argument we dealt with the question whether there was any evidence, binding upon Goodman, that any of the defendants either intended to export or actually did export the diamonds without a license. We now come to the other questions, which are of equal importance.

Let us assume, *arguendo*, that the Government can point to some evidence from which it might be inferred that Takahashi or another of the Japanese defendants did export the diamonds without a license. The evidence shows, nevertheless, that Goodman confined himself to the selling of the diamonds to Takahashi and that he had nothing to do with them after they reached Takahashi's hands. As far as the evidence goes, Goodman knew that the diamonds were intended for exportation, but there is not a scintilla of proof that he knew that there would be no license when they were exported. The conviction cannot be upheld without such proof.

As was said by this court in *Marino v. U. S.*, *supra*, 291 F. (2d) 691, 696:

“* * * he must know the purpose of the conspiracy, however, otherwise he is not guilty.”

Going a step further we contend that Goodman was not guilty even if he did know that Takahashi was purchasing the diamonds with the intention of exporting them unlawfully.

We submit that in *U. S. v. Falcone*, 311 U. S. 205, affirming 109 F. (2d) 579, the law was settled that one who supplies legitimate articles with knowledge that the purchaser intends to use them for criminal purposes does not thereby become a co-conspirator with the purchaser.

At one time this question gave rise to considerable difference of opinion in the federal courts throughout the country. In *Pattis v. U. S.*, 9 Cir., 17 F. (2d) 562, this court affirmed the rule that a supplier of legitimate materials is guilty if he had notice of the future criminal destination of the materials. This rule was followed in the majority of the circuits. On the other hand, it was held in *Young v. U. S.*, 5 Cir., 48 F. (2d) 26, that a mere sale with knowledge of criminal destination, without actual participation in the criminal activities, does not make one a criminal.

The question was finally settled in *U. S. v. Falcone*, *supra*, 2 Cir., 109 F. (2d) 579, affirmed 311 U. S. 205. In that case a number of defendants were convicted of a widespread conspiracy to operate illicit stills. Four of the defendants were convicted for having sold or helped to sell to the distillers sugar, yeast, and cans, out of which the alcohol was distilled, or in which it was sold. On appeal these defendants challenged the sufficiency of the evidence. The Circuit Court fully discussed the evidence and stated that it would be assumed that these defendants knew the eventual destination of the goods which they supplied. In reversing the convictions of these four defendants the court said (p. 581):

“In the light of all this, it is apparent that the first question is whether the seller of goods, in themselves innocent, becomes a conspirator with—or, what is in substance the same thing, an abettor of—

the buyer because he knows that the buyer means to use the goods to commit a crime.”

The court then reviewed the divergence of opinion in the various circuits about the answer to that question and came to the conclusion that it would follow the view expressed in the *Young* case, *supra*, 47 F. (2d) 26, that the supplier and his helpers are not guilty under such circumstances. The court then continued (p. 581):

“It is not enough that he does not forego a normally lawful activity, of the fruits of which he knows that others will make an unlawful use; he must in some sense promote their venture himself, make it his own, have a stake in its outcome. The distinction is especially important today when so many prosecutors seek to sweep within the drag-net of conspiracy all those who have been associated in any degree whatever with the main offenders. That there are opportunities of great oppression in such a doctrine is very plain, and it is only by circumscribing the scope of such all comprehensive indictments that they can be avoided. We may agree that morally the defendants at bar should have refused to sell to illicit distillers; but, both morally and legally, to do so was *toto coelo* different from joining with them in running the stills.”

In order to resolve the conflict of the decisions, the Supreme Court granted certiorari (310 U. S. 620) and, after hearing argument on this question, unanimously affirmed the decision of the Circuit Court in an opinion by Mr. Justice, now Chief Justice, Stone. (311 U. S. 205.)

The opinion of the Supreme Court is copied in full in Appendix I.

With the principle now settled that a supplier's mere knowledge of criminal destination does not make him a criminal, it must necessarily follow that Goodman's conviction cannot be upheld regardless whether he did or did not have knowledge that the diamonds would eventually be exported without a license.

Summary of Fourth and Fifth Assignments of Error.
[R. 135-150; Appendix II of This Brief.]

THE COURT ERRED IN THE DENIAL OF THE MOTION TO STRIKE OUT THE TESTIMONY BY THE DEFENDANT NAKAUCHI THAT THE DEFENDANT TAKIZAWA HAD TOLD HIM THAT THERE WERE DIAMONDS IN A PACKAGE WHICH HE TOOK TO SAN FRANCISCO. THE REFERENCE TO THAT TESTIMONY DURING THE GOVERNMENT'S CLOSING ARGUMENT, BOTH BY THE TRIAL COURT AND THE UNITED STATES ATTORNEY, ACCENTUATED THE ERROR AND CAUSED SUBSTANTIAL HARM TO THE APPELLANT.

This evidence and the objections and colloquy regarding it were fully copied on pages 20-21 of this brief. On pages 24-25 we also set forth our argument and supporting authorities against its admissibility and there is no need of repetition.

It has also been mentioned that during the Government's closing argument the United States Attorney referred to this testimony of Nakauchi and told the jury that it could be inferred from it that the diamonds had been taken to San Francisco and thus on a boat to Japan;

that there was an exception taken to this argument; and that the court then summarized and emphasized the testimony of the jury. [R. 116-117.]

It is therefore obvious that this evidence was highly damaging and substantially contributed to the adverse verdict, for the Government relied upon it as one of the props of its case.

In the recent cases of *McCandles v. U. S.*, 298 U. S. 342, and *Lynch v. Oregon Lumber Co.*, 9 Cir., 108 F. (2d) 283, it was held that when error is shown by an appellant there should be a reversal, unless it affirmatively appears from the whole record that it was not prejudicial. Under this principle it must be presumed that the erroneous admission of Nakauchi's testimony and the denial of the motion to strike it call for a reversal.

Moreover, admission of hearsay evidence in conspiracy cases has generally been held to be reversible error, especially when, as in this case, it is a principal factor in proving the Government's case. Thus in *Oras v. U. S.*, 9 Cir., 67 Fed. (2d) 462, and *Poole v. U. S.*, 9 Cir., 97 Fed. (2d) 423, both conspiracy cases, this court reversed the convictions because hearsay testimony was erroneously admitted against the defendants.

This verdict being based upon hearsay evidence therefore violates a basic right of an accused under our system of free government—the right to be confronted by the accusing witnesses and not to be convicted by the testimony of a witness as to what he heard from someone else who was not then under oath nor subject to cross-examination.

Conclusion.

Appellant's plea for a reversal and a dismissal of the charge against him is being submitted to this court at a time when our country is going through trying experiences. The ghastly and murderous "stab in the back" of December 7, 1941, has revealed the true and treacherous make-up of the numerous Japanese nationals who for many years carried on their nefarious activities in this fair land under the guise of friendly trading.

It is for that reason that the stigma of a conviction for having intentionally helped traitors in the violation of our defensive laws weighs more heavily on the appellant than the imprisonment and fine which have been imposed.

Looking at the situation in retrospect—as one should in judging appellant's action in the summer and early fall of 1941—we find that appellant's sales to Takahashi were only a small item in the vast amount of material, including iron, steel and oil, then sold by Americans to Japan—with the approval of the Government—under the mistaken expectation that war would thereby be avoided. Events have now taught us that it might have been wiser to have withheld these vast resources from the enemy and to have then risked an armed conflict. But this is at best only hindsight and does not stamp appellant's past dealings as criminal at that time.

Looking at the situation from the judicial standpoint—by transposing oneself into the period before December 7

when the acts took place—one fails to find any evidence that appellant was a criminal.

We therefore beseech this court to reaffirm in this case the basic right so dear to us—in contrast with the tyranny of the dictators—that an accused is innocent until by legally sufficient evidence he is proved guilty beyond a reasonable doubt.

Respectfully submitted,

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Attorneys for Appellant.

MAX BERGMAN,

Of Counsel.

APPENDIX I.

United States v. Falcone, 311 U. S. 205.

Mr. Justice Stone delivered the opinion of the Court.

The question presented by this record is whether one who sells materials with knowledge that they are intended for use or will be used in the production of illicit distilled spirits may be convicted as a co-conspirator with a distiller who conspired with others to distill the spirits in violation of the revenue laws.

Respondents were indicted with sixty-three others in the northern district of New York for conspiring to violate the revenue laws by the operation of twenty-two illicit stills in the vicinity of Utica, New York. The case was submitted to the jury as to twenty-four defendants, of whom the five respondents and sixteen operators of stills were convicted. The Court of Appeals for the Second Circuit reversed the conviction of the five respondents on the ground that as there was no evidence that respondents were themselves conspirators, the sale by them of materials, knowing that they would be used by others in illicit distilling, was not sufficient to establish that respondents were guilty of the conspiracy charged. 109 F. 2d 579. We granted certiorari, 310 U. S. 620, to resolve an asserted conflict of the decision below with those of courts of appeals in other circuits. *Simpson v. United States*, 11 F. 2d 591; *Pattis v. United States*, 17 F. 2d 562; *Borgia v. United States*, 78 F. 2d 550; *Marino v. United States*, 91 F. 2d 691; see *Backun v. United States*, 112 F. 2d 635. Compare *Young v. United States*, 48 F. 2d 26.

All of respondents were jobbers or distributors who, during the period in question, sold sugar, yeast or cans,

some of which found their way into the possession and use of some of the distiller defendants. The indictment while charging generally that all the defendants were parties to the conspiracy did not allege specifically that any of respondents had knowledge of the conspiracy but it did allege that respondents Alberico and Nole brothers sold the materials mentioned knowing that they were to be used in illicit distilling. The court of appeals, reviewing the evidence thought, in the case of some of the respondents, that the jury might take it that they were knowingly supplying the distillers. As to Nicholas Nole, whose case it considered most doubtful, it thought that his equivocal conduct "was as likely to have come from a belief that it was a crime to sell the yeast and the cans to distillers as from being in fact any further involved in their business." But it assumed for purposes of decision that all furnished supplies which they knew ultimately reached and were used by some of the distillers. Upon this assumption it said, "In the light of all this, it is apparent that the first question is whether the seller of goods, in themselves innocent, becomes a conspirator with—or, what is in substance the same thing, an abettor of—the buyer because he knows that the buyer means to use the goods to commit a crime." And it concluded that merely because respondent did not forego a "normally lawful activity of the fruits of which he knew that others were making unlawful use" he is not guilty of a conspiracy.

The Government does not argue here the point which seems to be implicit in the question raised by its petition for certiorari, that conviction of conspiracy can rest on proof alone of knowingly supplying an illicit distiller, who is not conspiring with others. In such a case, as the

Government concedes, the act of supplying or some other proof must import an agreement or concert of action between buyer and seller, which admittedly is not present here. Cf. *Gebardi v. United States*, 287 U. S. 112, 121; *Di Vonaventura v. United States*, 15 F. 2d 494. But the Government does contend that one who with knowledge of a conspiracy to distill illicit spirits sells materials to a conspirator knowing that they will be used in the distilling, is himself guilty of the conspiracy. It is said that he is, either because his knowledge combined with his action makes him a participant in the agreement which is the conspiracy, or what is the same thing he is a principal in the conspiracy as an aider or abettor by virtue of 332 of the Criminal Code, 18 U. S. C. §550, which provides: "Whoever directly commits any act constituting an offense defined in any law of the United States, or aids, abets, counsels, commands, induces or procures its commission, is a principal."

The argument, the merits of which we do not consider, overlooks the fact that the opinion below proceeded on the assumption that the evidence showed only that respondents or some of them knew that the materials sold would be used in the distillation of illicit spirits, and fell short of showing respondents' participation in the conspiracy or that they knew of it. We did not bring the case here to review the evidence, but we are satisfied that the evidence on which the Government relies does not do more than show knowledge by respondents that the materials would be used for illicit distilling if it does as much in the case of some. In the case of Alberico, as in the case of Nicholas Nole, the jury could have found that he knew that one of their customers who is an un-

convicted defendant was using the purchased material in illicit distilling. But it could not be inferred from that or from the casual and unexplained meetings of some of respondents with others who were convicted as conspirators that respondents knew of the conspiracy. The evidence respecting the volume of sales to any known to be distillers is too vague and inconclusive to support a jury finding that respondents knew of a conspiracy from the size of the purchases even though we were to assume what we do not decide that the knowledge would make them conspirators or aiders or abettors of the conspiracy. Respondents are not charged with aiding and abetting illicit distilling, and they cannot be brought within the sweep of the Government's conspiracy dragnet if they had no knowledge that there was a conspiracy.

The gist of the offense of conspiracy as defined by 37 of the Criminal Code, 18 U. S. C. §88, is agreement among the conspirators to commit an offense attended by an act of one or more of the conspirators to effect the object of the conspiracy. *Pettibone v. United States*, 148 U. S. 197; *Marino v. United States*, *supra*; *Troutman v. United States*, 100 F. 2d 628; *Beland v. United States*, 100 F. 2d 289; cf. *Gebardi v. United States*, *supra*. Those having no knowledge of the conspiracy are not conspirators, *United States v. Hirsch*, 100 U. S. 33, 34; *Weniger v. United States*, 47 F. 2d 692, 693; and one who without more furnishes supplies to an illicit distiller is not guilty of conspiracy even though his sale may have furthered the object of a conspiracy to which the distiller was a party but of which the supplier had no knowledge. On this record we have no occasion to decide any other question.

Affirmed.

APPENDIX II.

Fourth Assignment of Error.

[R. 135-137.]

During the examination of the witness Nakauchi for the Government the following took place:

“Examination by Mr. Silverstein:

Q. Other than that, have you ever received any other diamonds? A. Yes, once.

Q. From whom? A. I think either Mr. Takahashi or Mr. Takizawa.

Q. And when was that? A. The end of July, I think.

* * * * *

Q. What did you do with them? A. I at one time had in my hand a bag or something that contained diamonds.

Q. What did you do with them after you received them? A. I left them in a certain room in a hotel in San Francisco.

Q. You did that yourself? A. Yes.

The Court: Who gave you the diamonds?

The Witness: I think I received them from Mr. Takizawa.

The Court: Did you take them to San Francisco?

The Witness: My friend was returning to Japan and I chauffeured him up there.

By Mr. Silverstein:

Q. You chauffeured somebody that was going back to Japan? A. Yes.

Q. You drove somebody up north, is that it? A. Yes.

The Court: You took the diamonds with you?

The Witness: I do not know whether I had the diamonds or not, but I understood—I heard that the diamonds were in that bag.

Mr. Peterson: That, of course, ought to be stricken.

The Court: Just a moment. I will find out. What bag?

The Witness: A portable phonograph.

The Court: Who told you there were diamonds in there?

The Witness: Mr. Takizawa.

The Court: Is that one of the defendants in this case?

The Witness: The man that testified here before me.

Mr. Peterson: I now move to strike the testimony relative to the San Francisco episode upon the grounds that it has nothing to do with any of the issues in this case, entirely outside of the scope of this indictment; it is hearsay as against the defendant whom I represent.

The Court: It is a statement by a co-defendant. He said the satchel or bag contained industrial diamonds, and he took them to San Francisco.

Mr. Peterson: My recollection of his testimony is that he was told that they contained it.

The Court: He said one of the defendants told him. That would be binding, if there is a conspiracy.

Mr. Peterson: If it was within the scope of the indictment.

The Court: Objection overruled.

Mr. Peterson: Note an exception. May it be understood that if one of us makes an objection, it may be deemed by the other counsel."

The admission of the testimony of the witness Nakauchi, herein quoted, as to the facts that the bag or portable phonograph contained diamonds and that the defendant Takizawa told him that there were diamonds in the bag, and the refusal to strike the testimony were erroneous for the reason that the testimony was hearsay and inadmissible.

Fifth Assignment of Error.

[R. 137-140.]

During the closing argument on behalf of the Government the following took place:

"Now let me say to you, this is a conspiracy charge, and if these defendants, or either of them, knew that the Japanese were purchasing these diamonds for export purposes, and they aided and abetted, they are guilty under the law with knowledge of the conspiracy, if we show that beyond a reasonable doubt, because they don't have to take active part; if they do anything in furtherance of the object of that conspiracy, with knowledge of it, under the law they are a party to it, they are a partnership, they are an agent for one another; and if these Japanese took these diamonds, and there is evidence before you that Takizawa went up to San Francisco in an automobile with another Japanese who was leaving for Japan—I don't know whether those diamonds went aboard the boat; I say that you have a right to infer that they did; that they went aboard one of the Japanese boats to

get over to Japan—I say the evidence would give you the right to infer, after considering all of the evidence together, that that is just what took place, and that is what would have taken place on the other diamonds if they could have gotten away with it because there are ways that you know of to smuggle out of the United States.

Mr. Peterson: I want to take an exception to Mr. Silverstein's statement that the Japanese was going to San Francisco and then to Japan.

Mr. Silverstein: I didn't say that. I say there was a Japanese that was going to Japan.

The Court: The Court recalls testimony where Takizawa—I think that is the way you pronounce it—went to San Francisco with another Japanese who was leaving for Japan; and one of the witnesses anyhow testified that he took this Japanese friend that was going to Japan, took the diamonds to San Francisco, and the last time he saw them was in a hotel room.

Mr. Silverstein: That was Nakauchi, not Takizawa; I was wrong about the name.

So, therefore, some of the diamonds undoubtedly reached over there because letters came back to Takahashi concerning the quality, and you have a right, I believe, to infer that, from the facts we have shown you here, that logically, reasonably and honestly, and in all fairness to the defendant, you should conclude that they did reach there because of what came back and the conversations that Takahashi had with these defendants concerning the quality of the diamonds."

The statement by Mr. Silverstein that Takizawa went to San Francisco with another Japanese who was leaving for Japan and the statement by the Court that there was testimony that Takizawa went to San Francisco with another Japanese who was leaving for Japan and that there was testimony by one of the witnesses that he took this friend that was going to Japan, took the diamonds to San Francisco, and the last time he saw them was in a hotel room, were erroneous for the reasons that there was no admissible testimony as to such facts and that the only testimony in the record upon which such statements could be based was the testimony by Nakauchi, which is quoted in the 4th error of these assignments, and which testimony was inadmissible and should have been stricken.

No. 9989.

7

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

HYMAN HOWARD GOODMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF FOR THE UNITED STATES.

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FILED

TOPICAL INDEX.

	PAGE
Statement of the case.....	1
Statement of facts.....	4
The conspiracy was to export industrial diamonds to Japan without a license.....	4
Appellant Goodman's connection with the conspiracy.....	6
Questions involved	8
Summary of argument.....	8
Argument	10

I.

The District Court did not err in denying the motions for a directed verdict of not guilty against the appellant Goodman, made at the end of the Government's case and at the end of the entire case.....	10
---	----

II.

The District Court did not err in overruling the objections and denying the motions to strike with respect to the testimony of the witness Nakauchi.....	28
--	----

III.

The reference made to the testimony of the witness Nakauchi by the District Court and by the United States Attorney did not constitute prejudicial and reversible error.....	32
Conclusion	34

ii.

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Abrams v. United States, 250 U. S. 616.....	13, 16
Ader v. United States, 284 Fed. 13.....	19
Allen v. United States, 89 Fed. (2d) 954.....	21
Antess v. United States, 22 Fed. (2d) 594.....	25
Barone v. United States, 94 Fed. (2d) 902.....	17
Bartkus v. United States, 21 Fed. (2d) 425.....	30
Bentel v. United States, 13 Fed. (2d) 327, cert. den. 273 U. S. 713.....	13
Berlin v. United States, 14 Fed. (2d) 497.....	13
Bold v. United States, 265 Fed. 581.....	13, 14, 15
Borgia v. United States, 78 Fed. (2d) 550, cert. den. 296 U. S. 615	25, 33
Brady v. United States, 24 Fed. (2d) 405.....	19
Brolaski v. United States, 279 Fed. 1, cert. den. 258 U. S. 625	14
Brown v. United States, 16 Fed. (2d) 682.....	21
Brown v. United States, 43 Fed. (2d) 906.....	20
Brown v. United States, 150 U. S. 98.....	29
Burton v. United States, 202 U. S. 344.....	16, 18
Callan v. Wilson, 127 U. S. 540.....	18
Clune v. United States, 159 U. S. 590.....	18
Coates v. United States, 59 Fed. (2d) 173.....	28, 29, 31
Cohen v. United States, 214 Fed. 23, cert. den. 235 U. S. 696....	13
Cooper v. United States, 232 Fed. 81, cert. den. 241 U. S. 675	13
Coplin v. United States, 88 Fed. (2d) 652, cert. den. 301 U. S. 703	14, 17
Craig v. United States, 81 Fed. (2d) 816, cert. den. 298 U. S. 690	12, 16
Crono v. United States, 59 Fed. (2d) 339.....	11, 12
Cummings v. United States, 15 Fed. (2d) 168.....	28

iii.

	PAGE
Dahly v. United States, 50 Fed. (2d) 37.....	21
Dealy v. United States, 152 U. S. 539.....	21
Driskill v. United States, 281 Fed. 146.....	15
Duckwitz v. United States, 15 Fed. (2d) 195.....	16
Felder v. United States, 9 Fed. (2d) 872, cert. den. 270 U. S. 648	15
Ford v. United States, 10 Fed. (2d) 339, cert. den. 273 U. S. 593	19, 31
Galatas v. United States, 80 Fed. (2d) 15.....	11, 15
Ghadiali v. United States, 17 Fed. (2d) 236, cert. den. 274 U. S. 747.....	17
Gorin v. United States, 111 Fed. (2d) 712, aff. 312 U. S. 19....	12, 14
Hedderly v. United States, 193 Fed. 561.....	13, 14
Heskett v. United States, 58 Fed. (2d) 897, cert. den. 287 U. S. 643.....	20
Hinkhouse v. United States, 266 Fed. 977.....	16
Hubinger Co. v. United States, 64 Fed. (2d) 772.....	25
Humes v. United States, 170 U. S. 210.....	16
Hyde v. United States, 35 App. D. C. 451, aff. 225 U. S. 347....	32
Joplin Mercantile Co. v. United States, 236 U. S. 531.....	18
Kennedy v. United States, 44 Fed. (2d) 131.....	21
Knable v. United States, 9 Fed. (2d) 567.....	11, 14
Laska v. United States, 82 Fed. (2d) 672, cert. den. 298 U. S. 689	29
Lempie v. United States, 39 Fed. (2d) 19.....	15, 16
Levey v. United States, 92 Fed. (2d) 688, cert. den. 303 U. S. 639	31
Levine v. United States, 79 Fed. (2d) 364.....	31
Logan v. United States, 144 U. S. 263.....	29

iv.

	PAGE
Malone v. United States, 94 Fed. (2d) 281, cert. den. 304 U. S. 562.....	33
Marino v. United States, 91 Fed. (2d) 691, cert. den. 302 U. S. 764.....	28, 31
Mayola v. United States, 71 Fed. (2d) 65.....	30
McDonough v. United States, 299 Fed. 30, cert. den. 266 U. S. 613	14
Metzler v. United States, 64 Fed. (2d) 203.....	14, 16, 28
Middleton v. United States, 49 Fed. (2d) 538.....	21
Morgan v. Devine, 237 U. S. 632.....	18
Parmagini v. United States, 42 Fed. (2d) 721.....	19
Pattis v. United States, 17 Fed. (2d) 562.....	25
Pierce v. United States, 252 U. S. 239.....	12
Profft v. United States, 264 Fed. 299.....	19
Rendleman v. United States, 38 Fed. (2d) 779.....	11, 14, 16
Richards v. United States, 175 Fed. 911.....	32
Rudner v. United States, 281 Fed. 516.....	25
Sloan v. United States, 287 Fed. 91.....	11, 14
Soininen v. United States, 279 Fed. 419.....	11
Stilson v. United States, 250 U. S. 583.....	12, 16
Terry v. United States, 7 Fed. (2d) 28.....	28
Thompson v. Johnston, 94 Fed. (2d) 355.....	19
Tofanelli v. United States, 28 Fed. (2d) 581.....	30
United States v. Bender, 60 Fed. (2d) 56, cert. den. 287 U. S. 598.....	15
United States v. Britton, 108 U. S. 199.....	21
United States v. Falcone, 311 U. S. 205.....	25, 26, 27
United States v. Holte, 236 U. S. 140	18, 20
United States v. Manton, 107 Fed. (2d) 834.....	29, 31
United States v. Peoni, 100 Fed. (2d) 401.....	26

v.

	PAGE
United States v. Rabinowich, 238 U. S. 78.....	18, 20
United States v. Ross, 92 U. S. 281.....	21
United States v. Scarborough, 57 Fed. (2d) 137.....	4, 12
United States v. Socony Vacuum Oil Co., 310 U. S. 150.....	13
United States v. Stevenson (No. 2), 215 U. S. 200.....	18
Van Riper v. United States, 13 Fed. (2d) 961, cert. den. 273 U. S. 702.....	31
Vilson v. United States, 61 Fed. (2d) 901.....	12, 15
Vukich v. United States, 28 Fed. (2d) 666.....	25
Wiborg v. United States, 163 U. S. 632.....	31
Williamson v. United States, 207 U. S. 425.....	19, 20
Young v. United States, 48 Fed. (2d) 26.....	26

STATUTES.

Presidential Proclamation of July 2, 1940 (No. 2413).....	2
Revised Statutes, Sec. 5440; May 17, 1897, c. 8, 21 Stat. 4; Mar. 4, 1909, c. 321, Sec. 37, 35 Stat. 1096.....	1
Statutes, Proclamations, and Executive Orders Pertaining to National Defense Matters (U. S. Dept. of Justice, Jan. 15, 1941)	2
United States Code, Title 18, Sec. 88 (Criminal Code, Sec. 37)	1, 19
United States Code, Title 50, Sec. 99, c. 508, Sec. 6, 54 Stat. 714	2

TEXTBOOKS.

5 Cyclopedia of Federal Procedure, Sec. 2272, p. 659.....	15, 17
O'Brien, Manual on Federal Appellate Procedure (1941) 88....	11, 12

No. 9989.

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

HYMAN HOWARD GOODMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

BRIEF FOR THE UNITED STATES.

Statement of the Case.

An indictment was returned by the Grand Jury in the Central Division of the Southern District of California, on October 22, 1941, charging Kichiro Takizawa, George M. Nakauchi, Kenkichi Takahashi, Hyman Howard Goodman, Elwood L. Keeler, Hiroshi Yamaguchi with violating Title 18, United States Code, Section 88,¹ in that they did, prior to the dates of the commission of the overt acts hereinafter set forth, knowingly, wilfully, unlawfully, corruptly and feloniously conspire, combine, confederate,

¹Title 18, United States Code, Section 88 (Criminal Code, Section 37).

If two or more persons conspire either to commit any offense against the United States, or to defraud the United States in any manner or for any purpose, and one or more of such parties do any act to effect the object of the conspiracy, each of the parties to such conspiracy shall be fined not more than \$10,000, or imprisoned not more than two years, or both. (R. S. §5440; May 17, 1897, c. 8, 21 Stat. 4; Mar. 4, 1909, c. 321, §37, 35 Stat. 1096.)

arrange and agree to commit an offense against the United States of America, namely, the violation of Title 50, United States Code, Section 99,² and the Presidential Proclamation, dated July 2, 1940 (No. 2413),³ which made it unlawful to export industrial diamonds from the United States without authorization of a license from the Secretary of State, as required by said Presidential Proclamation.

Certain overt acts are set forth in the indictment, among which are the following:

1. During the month of August, 1941, the exact date being to the grand jurors unknown, defendant Hiroshi Yamaguchi furnished the sum of \$13,000.00 to defendant Kichiro Takizawa;

²Title 50, United States Code, Section 99.

Whenever the President determines that it is necessary in the interest of national defense to prohibit or curtail the exportation of any military equipment or munitions, or component parts thereof, or machinery, tools, or material, or supplies necessary for the manufacture, servicing, or operation thereof, he may by proclamation prohibit or curtail such exportation, except under such rules and regulations as he shall prescribe. Any such proclamation shall describe the articles or materials included in the prohibition or curtailment contained therein. In case of the violation of any provision of any proclamation, or of any rule or regulation, issued hereunder, such violator or violators, upon conviction, shall be punished by a fine of not more than \$10,000, or by imprisonment. The authority granted in this section shall terminate June 30, 1942, unless the Congress shall otherwise provide. July 2, 1940, 10:55 a. m., E. S. T., c. 508, §6, 54 Stat. 714.

³Presidential Proclamation of July 2, 1940 (No. 2413).

" . . . And I do hereby further proclaim that upon the recommendation of the aforesaid Administrator of Export Control, I have determined that it is necessary in the interest of the national defense that on and after July 5, 1940, the articles and materials hereinafter listed shall not be exported from the United States except when authorized in each case by a license as hereinafter provided: . . .

"i. Industrial diamonds.

" . . . And I do hereby empower the Secretary of State to issue licenses authorizing the exportation of any of the said articles and material . . ."

Statutes, Proclamations, and Executive Orders Pertaining to National Defense Matters (U. S. Dept. of Justice, Jan. 15, 1941).

2. On or about August 11, 1941, defendant Elwood L. Keeler sold to defendant Hyman Howard Goodman in the presence of defendant Kenkichi Takahashi approximately \$2210.11 worth of industrial diamonds;

3. On or about September 4, 1941, defendant Elwood L. Keeler sold to defendant Hyman Howard Goodman in the presence of defendants Kenkichi Takahashi and Kichiro Takizawa approximately \$3731.00 worth of industrial diamonds;

4. On or about September 16, 1941, defendants Elwood L. Keeler, Hyman Howard Goodman, Kenkichi Takahashi, Kichiro Takizawa and George M. Nakauchi met at Los Angeles, California;

5. On or about October 16, 1941, defendant George M. Nakauchi had in his possession approximately \$15,000 worth of industrial diamonds [R. 2-4].

The defendants Takizawa, Nakauchi and Takahashi pleaded guilty, while the indictment was dismissed as to Yamaguchi upon the motion of the government. Thereafter appellant Goodman and the defendant Keeler were tried by a jury before the Honorable Ben Harrison, judge of the United States District Court for the Southern District of California, November 25-27, 1941, and were both found guilty. Upon this conviction the appellant Goodman was sentenced on December 1, 1941, to two years' imprisonment and to pay a fine of \$5000 [R. 6-8, 18-19]. It is from this sentence that the appellant Goodman now prosecutes the appeal herein.

Statement of Facts.

In general, the Government concedes that the statement of facts set forth by the appellant in his brief (pp. 2-11) is accurate as far as it goes and fairly complete. However, because of the misplacing of emphasis upon certain facts and the inadequate statement of other facts, the government deems it necessary to outline briefly the more salient facts indicating that a conspiracy to export industrial diamonds *without a license* existed and that appellant Goodman was intimately connected with and directly participated in it.

THE CONSPIRACY WAS TO EXPORT INDUSTRIAL DIAMONDS TO JAPAN WITHOUT A LICENSE.

It should be noted that appellant, in his brief, frankly admits that the Government at the trial introduced sufficient evidence to show a combination, conspiracy or agreement to purchase industrial diamonds for the purpose of exportation to Japan (App. Br. p. 14 *et seq.*). Even a casual perusal of the record, including the admissions by appellant Goodman himself [R. 64-68, 99-106], leads to the inescapable conclusion that such a conspiracy was established. The sole question therefore is whether or not the conspiracy was to export industrial diamonds *without a license*.

First of all it should be emphasized that none of the defendants named in the indictment had a license from the Secretary of State which would authorize or permit him to export industrial diamonds from the United States to Japan [R. 19], nor did appellant Goodman have such a license [R. 71].

Obviously the only purpose for the many transactions looking toward the purchase and delivery of industrial diamonds by Goodman, as well as the actual deliveries and payments made through Goodman, was to export those industrial diamonds to Japan. Goodman knew this because Takahashi told him so [R. 20]. And Goodman agreed to obtain the industrial diamonds for that purpose [R. 21-22, 24].

Not only did Goodman know that orders were coming from Japan, as indicated, but he also learned from Takahashi that an order had actually been received from Japan [Takahashi, R. 24; Takizawa, R. 47].

After the first shipments had been made to Japan Takahashi told Goodman that he had received letters from Japan referring to the quality of the industrial diamonds and demanding extra good quality [R. 30-31].

Takahashi knew that he could not send industrial diamonds to Japan without a license and, for that reason, asked Goodman to get an export license for him, thus putting Goodman on notice of the destination of the diamonds [R. 37].

Furthermore, there were a number of circumstances which indicated to Goodman that Takahashi wanted the industrial diamonds for the purpose of export to Japan, although he did not have such a license. For instance, Goodman had been associated in a company with Takahashi for several years prior to the conspiracy charged in the indictment herein, and that company had been formed for the purpose of exporting merchandise to Japan [R. 106]. Goodman also knew that Takahashi had just returned from Japan at the time of the negotiations for the purchase of industrial diamonds. Thus he was cer-

tainly put on notice that the destination of the industrial diamonds would be Japan, although Takahashi didn't have a license, and Goodman knew that there was an embargo on shipments to Japan [R. 112]. Goodman, in a signed statement, admitted that Takahashi, some time in either July, August or September, 1941, had told him that he could not pay for the diamonds "until the ship gets in" and that he would pay Goodman his commissions "when the boat arrives" [R. 66].

Keeler, one of the co-conspirators and a convicted defendant, freely admitted that the orders which he was receiving through Goodman from the Japanese were the first orders he had ever filled for Japanese [R. 95], and that the purchases thus made through Goodman by the Japanese were the largest in the history of the company [R. 94]. These facts also would seem to warrant an inference by the jury that the co-conspirators were buying and selling the industrial diamonds solely for the purpose of export to Japan *without a license*, since they all knew that none of them had a license.

APPELLANT GOODMAN'S CONNECTION WITH THE CONSPIRACY.

Goodman first met Takahashi some time in 1937 and had been associated with Takahashi from that time up until March 27, 1941, in a company which was exporting merchandise to Japan in 1939 [R. 99, 106]. In June of 1941, shortly after Takahashi had returned from Japan, Goodman discussed with him the possibility of obtaining

a number of items of merchandise, including industrial diamonds [R. 99-100]. Thereafter, from the middle of June, 1941, until September, 1941, Goodman had numerous negotiations with Takahashi, Takizawa and Nakauchi as purchasers, and Keeler and the Musto-Keenan Co. as sellers, of industrial diamonds [McCormick, R. 67; Goodman, R. 101-103; Takahashi, R. 23-34; Takizawa, R. 46-48; Nakauchi, R. 50; LeGrand, R. 76-80; Keeler, R. 87-91]. In all of these transactions Goodman acted as intermediary and broker, arranging for the sales and purchases himself. Some of the negotiations took place in his office [R. 31-2] and others occurred in the offices of the Musto-Keenan Co. [R. 31], but Goodman was the most active participant in all of them [Takahashi, R. 20-37; Takizawa, R. 46-49; Nakauchi, R. 50-51; Keeler, R. 87-91; Goodman, R. 99-106].

Furthermore, as pointed out above, appellant Goodman had full knowledge of the purpose for which the industrial diamonds were being purchased in such quantities, and knew full well that the ultimate destination of them, according to the understanding of all the parties to the conspiracy, was to be Japan, although none of the parties had a license to export as required by law. (See: Government's Statement of Facts herein under the heading "THE CONSPIRACY WAS TO EXPORT INDUSTRIAL DIAMONDS TO JAPAN WITHOUT A LICENSE.")

Questions Involved.

I. Did the District Court err in denying the motions for a directed verdict of not guilty against the appellant Goodman, made at the end of the Government's case and at the end of the entire case?

II. Did the District Court err in overruling the objections, and denying the motions to strike, with respect to the testimony of the witness Nakauchi?

III. Did the reference made to the testimony of the witness Nakauchi by the District Court and by the United States Attorney constitute prejudicial and reversible error?

Summary of Argument.

I. The District Court did not err in denying the motions for a directed verdict of not guilty against the appellant Goodman, made at the end of the Government's case and at the end of the entire case. The Circuit Court of Appeals will consider the evidence adduced at the trial in the light most favorable to the Government. If there was some competent and substantial evidence before the jury fairly tending to sustain the verdict, the action of the trial court in denying the motion for a directed verdict will not be reversed. The Appellate Court will not consider the weight of the evidence or pass upon the credibility of witnesses, since those determinations are exclusively within the province of the trial jury; and, if the evidence is conflicting, the verdict of the trial jury is conclusive, provided there was substantial evidence to sustain it. A conspiracy to commit a crime is different and totally distinguishable from the substantive offense, and thus to sustain the conviction for conspiracy it was not necessary for the Government to show that the sub-

stantive offense was consummated. While it is true that a mere supplier of goods who, without more, furnishes supplies to a member of a conspiracy of which the supplier had no knowledge and to which he was not a party, is not guilty of the conspiracy, nevertheless, where the supplier does engage in the conspiracy with full knowledge of its purpose and as an active participant, lending assistance in numerous ways, then he is guilty of the conspiracy.

II. The District Court did not err in overruling the objections and denying the motions to strike, with respect to the testimony of the witness Nakauchi. Wide latitude is permitted the trial court in admitting evidence of declarations and conduct of co-conspirators as proof of the unlawful conspiracy. Thus the acts and declarations of a co-conspirator performed and made after the conspiracy has been formed and in furtherance of its objects are admissible against all of the other co-conspirators, regardless of whether or not they had knowledge of those specific acts and declarations; and such acts and declarations are not hearsay when the Government has introduced other and independent evidence fairly tending to show the existence of the conspiracy.

III. The reference made to the testimony of the witness Nakauchi by the District Court and by the United States Attorney did not constitute prejudicial and reversible error. The control of the arguments of counsel made to the jury at the conclusion of trial is largely a matter of discretion for the trial court. Comments made by the prosecuting attorney in argument to the jury, where predicated upon admissible testimony, and such reasonable inferences as may be drawn therefrom are not prejudicial error; but, on the other hand, are proper and permissible in all respects.

ARGUMENT.

I.

The District Court Did Not Err in Denying the Motions for a Directed Verdict of Not Guilty Against the Appellant Goodman, Made at the End of the Government's Case and at the End of the Entire Case.

The appellant utilized Assignments of Error II and III, and seems to contend that the trial court committed reversible error in denying the motions for a directed verdict as to him [R. 133-135]. In support of this contention the appellant claims that the evidence fails to show that any crime was committed; that, at most, it merely indicates that industrial diamonds were purchased for the purpose of exportation to Japan; that there is no evidence tending to show that there was a conspiracy to export *without a license*, or that any of the diamonds were actually exported, or that, if they were exported, the person who exported them had no license [Appellant's Brief 14-29]. Further, in support of this contention, the appellant claims that his acts were in all respects lawful and that he is in the position of a mere supplier of goods and is therefore not shown to have been implicated in the conspiracy [Appellant's Brief 30-33].

Certain fundamental principles which have been laid down by this Honorable Circuit Court and other authorities with respect to review of a denial of motions for directed verdicts should be emphasized.

Upon review of the action of a trial court denying a motion for a directed verdict in a criminal case the reviewing court is under a duty to consider the evidence which was adduced at the trial in a light or aspect most favorable

to the Government. And this Honorable Circuit Court has so held on at least two occasions:

Rendleman v. United States, 38 Fed. (2d) 779, 780 (C. C. A. 9th, 1930);

United States v. Scarborough, 57 Fed. (2d) 137 (C. C. A. 9th, 1932).

Other Circuit Courts have invariably followed the same rule.

Knable v. United States, 9 Fed. (2d) 567, 569 (C. C. A. 6th, 1925);

Sloan v. United States, 287 Fed. 91, 92 (C. C. A. 8th, 1923);

Galatas v. United States, 80 Fed. (2d) 15, 23 (C. C. A. 8th, 1935).

See also:

O'Brien, Manual on Federal Appellate Procedure (1941) 88.

The scope of the appellate court's inquiry is further limited by the duty simply to declare whether the jury had the right to pass on what evidence there was before it, that is to say, merely whether there was sufficient evidence to warrant submission of the case to the jury.

Soininen v. United States, 279 Fed. 419 (C. C. A. 9th, 1922);

Crono v. United States, 59 Fed. (2d) 339, 340 (C. C. A. 9th, 1932).

Various tests have been stated and at times applied by appellate courts in carrying out this duty. The Supreme Court of the United States has pointed out that if there

was “substantial evidence tending to support the charges” against the defendants, the judgment of conviction based upon a verdict of guilty will not be reversed.

Stilson v. United States, 250 U. S. 583, 588 (1919);

Pierce v. United States, 252 U. S. 239, 251 (1920).

This Honorable Circuit Court has applied the same test in numerous cases, holding that it is not necessary in order to sustain a conviction that the appellate court be convinced beyond reasonable doubt that the defendant is guilty, since it is sufficient if there is present in the record “substantial evidence to sustain the verdict.”

Vilson v. United States, 61 Fed. (2d) 901 (C. C. A. 9th, 1932);

United States v. Scarborough, 57 Fed. (2d) 137 (C. C. A. 9th, 1932);

Craig v. United States, 81 Fed. (2d) 816, 827 (C. C. A. 9th, 1936), cert. den. 298 U. S. 690 (1936);

Gorin v. United States, 111 Fed. (2d) 712, 721 (C. C. A. 9th, 1940), aff. 312 U. S. 19 (1941).

Moreover, where it appears that there is substantial evidence in support of the charges, a trial court is actually in error if it does peremptorily direct an acquittal.

Crono v. United States, 59 Fed. (2d) 339, 340 (C. C. A. 9th, 1932);

Pierce v. United States, 252 U. S. 239, 251 (1920).

See also:

O'Brien, Manual on Federal Appellate Procedure (1941) 88.

Some courts have gone so far as to state that if there is "any evidence at all to sustain a verdict of guilty," the appellate court will not reverse the verdict for insufficiency of the evidence.

Hedderly v. United States, 193 Fed. 561, 571 (C. C. A. 9th, 1912);

Cohen v. United States, 214 Fed. 23, 27 (C. C. A. 2d, 1914), cert. den. 235 U. S. 696 (1914);

Cooper v. United States, 232 Fed. 81, 83 (C. C. A. 2d, 1916), cert. den. 241 U. S. 675 (1916);

Bentel v. United States, 13 Fed. (2d) 327 (C. C. A. 2d, 1926), cert. den. 273 U. S. 713 (1926);

Berlin v. United States, 14 Fed. (2d) 497 (C. C. A. 3d, 1926).

However, the more recent and probably the better view now is that the denial by the trial court of a motion for a directed verdict in a criminal case is reviewable only for the purpose of ascertaining "whether there was some competent and substantial evidence before the jury fairly tending to sustain the verdict."

United States v. Socony Vacuum Oil Co., 310 U. S. 150, 254 (1940);

Abrams v. United States, 250 U. S. 616, 619 (1919);

Bold v. United States, 265 Fed. 581, 583 (C. C. A. 9th, 1920).

This Honorable Circuit Court has likewise consistently held that upon review of the denial by the trial court of a motion for directed verdict, the Circuit Court of Appeals cannot be called upon to weigh the testimony or substitute

its judgment of the evidence for that of the jury, since the determination of what weight to attach to the evidence adduced in the course of the trial is solely within the province of the jury, provided only that there has been presented for the jury's consideration some competent and substantial evidence fairly tending to prove the charges of the indictment.

Hedderly v. United States, 193 Fed. 561, 571 (C. C. A. 9th, 1912);

Bold v. United States, 265 Fed. 581, 583 (C. C. A. 9th, 1920);

Brolaski v. United States, 279 Fed. 1, 3 (C. C. A. 9th, 1922), cert. den. 258 U. S. 625 (1922);

McDonough v. United States, 299 Fed. 30, 38 (C. C. A. 9th, 1924), cert. den. 266 U. S. 613 (1924);

Rendleman v. United States, 38 Fed. (2d) 779, 780 (C. C. A. 9th, 1930);

Metzler v. United States, 64 Fed. (2d) 203, 209 (C. C. A. 9th, 1933);

Coplin v. United States, 88 Fed. (2d) 652, 664 (C. C. A. 9th, 1937), cert. den. 301 U. S. 703 (1937);

Gorin v. United States, 111 Fed. (2d) 712, 721 (C. C. A. 9th, 1940), aff'd 312 U. S. 19 (1941).

See also:

Sloan v. United States, 287 Fed. 91, 92 (C. C. A. 8th, 1923);

Knable v. United States, 9 Fed. (2d) 567 (C. C. A. 6th, 1925);

United States v. Bender, 60 Fed. (2d) 56, 57 (C. A. 2d, 1932), cert. den. 287 U. S. 598 (1932);
Galatas v. United States, 80 Fed. (2d) 15, 23 (C. A. 8th, 1935).

Accordingly, if there was adduced at the trial any competent and substantial evidence fairly tending to prove the facts charged, an appellate court will not disturb a conviction based upon a verdict of guilty, even though the evidence is highly conflicting.

Driskill v. United States, 281 Fed. 146 (C. C. A. 9th, 1922);
Bold v. United States, 265 Fed. 581, 583 (C. C. A. 9th, 1920);
5 *Cyc. Fed. Proc.*, Sec. 2272, p. 659.

It is the exclusive function of the jury to determine the weight that should be given to the testimony, and both trial courts and appellate courts are excluded from interfering with this function.

Lempie v. United States, 39 Fed. (2d) 19, 20 (C. A. 9th, 1930);
Vilson v. United States, 61 Fed. (2d) 901 (C. C. A. 9th, 1932).

In other words, that reasonable doubt which often prevents conviction must be the jury's doubt, and not that of any court, either of original or of appellate jurisdiction.

Craig v. United States, 81 Fed. (2d) 816, 827 (C. A. 9th, 1936), cert. den. 298 U. S. 690 (1936);
Felder v. United States, 9 Fed. (2d) 872, 875 (C. A. 2d, 1925), cert. den. 270 U. S. 648 (1926).

From this it follows that where there is sufficient evidence to go to the jury, an appellate court will not weigh the facts or pass judgment upon the relative merits of conflicting testimony. Such is for the jury, and for the jury alone, whose determination in that respect is conclusive.

Humes v. United States, 170 U. S. 210, 213 (1898);

Burton v. United States, 202 U. S. 344, 373 (1906);

Stilson v. United States, 250 U. S. 583, 588 (1919);

Abrams v. United States, 250 U. S. 616, 619 (1919).

Not only is an appellate court precluded from inquiring into the weight of the testimony and the propriety of inferences which a jury may draw therefrom, but it will refrain as a matter of course from passing upon the credibility of the witnesses. In other words, an appellate court will not invade another exclusive province of the jury, namely, the function of determining the credibility of witnesses.

Hinkhouse v. United States, 266 Fed. 977, 978 (C. C. A. 9th, 1920);

Duckwitz v. United States, 15 Fed. (2d) 195, 196 (C. C. A. 9th, 1926);

Lempie v. United States, 39 Fed. (2d) 19, 20 (C. C. A. 9th, 1930);

Rendleman v. United States, 38 Fed. (2d) 779, 780 (C. C. A. 9th, 1930);

Metzler v. United States, 64 Fed. (2d) 203, 209 (C. C. A. 9th, 1933);

Coplin v. United States, 88 Fed. (2d) 652, 664 (C. C. A. 9th, 1937), cert. den. 301 U. S. 703 (1937);

Barone v. United States, 94 Fed. (2d) 902 (C. C. A. 9th, 1938);

5 *Cyc. Fed. Proc.*, Sec. 2272, p. 659.

The reason for this limitation has been succinctly phrased in *Ghadiali v. United States*, 17 Fed. (2d) 236 (C. C. A. 9th, 1927), cert. den. 274 U. S. 747 (1927), where the court stated, at page 237:

“The jury had before it all of the witnesses, could observe their demeanor, the reasonableness of the story, the opportunity of the witnesses for knowing the things about which they testified, the interest or lack of interest in the result of the trial and all other disclosed circumstances bearing upon the credibility of the witnesses, and could determine where the truth in the case lay and, if there is any evidence upon which rational minds might arrive at a like conclusion, this court cannot reverse the finding.”

In the light of these well-settled principles and applying the tests indicated, it is clear that the contention pressed by the appellant on the appeal herein that the trial court erred in permitting the case to go to the jury is as unfounded in law as it is in the Record.

It should be remembered that the charge here is of conspiracy, and not of the commission of the substantive offense of exporting industrial diamonds without a license. For the purpose of this appeal, therefore, it is sufficient if the Record contains substantial evidence fairly tending to show that appellant Goodman participated in a conspiracy to export industrial diamonds without a license.

Of course, at the trial the burden of proof was upon the Government to show that such a conspiracy existed, but it was *not* necessary for the Government to prove that any *actual* exportation occurred. Consequently the authorities cited in appellant's brief (p. 18) have no pertinency to this appeal.

As was stated in the leading case on the subject:

"A conspiracy to commit a crime is a different offense from the crime that is the object of the conspiracy. * * * The conspiracy, however fully formed, may fail of its object, however earnestly pursued; the contemplated crime may never be consummated; yet the conspiracy is nonetheless punishable."

United States v. Rabinowich, 238 U. S. 78, 85-6 (1915).

This is but an amplified statement of the well-known rule that a conspiracy to commit a crime is different and totally distinguishable from the substantive offense.

See:

Callan v. Wilson, 127 U. S. 540, 555 (1888);

Clune v. United States, 159 U. S. 590, 595 (1895);

United States v. Stevenson (No. 2), 215 U. S. 200, 203 (1909);

Burton v. United States, 202 U. S. 344, 347 (1906);

Morgan v. Devine, 237 U. S. 632, 640 (1915);

United States v. Holte, 236 U. S. 140, 144 (1915);

Joplin Mercantile Co. v. United States, 236 U. S. 531, 535, 536 (1915).

Since conspiracy is separate and distinct from the substantive offense the essence of it as a crime is the unlawful combination, regardless of whether or not the purpose of the conspiracy is accomplished.

Proffit v. United States, 264 Fed. 299, 300 (C. C. A. 9th, 1920).

See, also:

Ford v. United States, 10 Fed. (2d) 339, 343 (C. C. A. 9th, 1926);

Parmagini v. United States, 42 Fed. (2d) 721, 725 (C. C. A. 9th, 1930);

Ader v. United States, 284 Fed. 13 (C. C. A. 7th, 1922);

Brady v. United States, 24 Fed. (2d) 405 (C. C. A. 8th, 1928);

Thompson v. Johnston, 94 Fed. (2d) 355 (C. C. A. 9th, 1938).

Moreover, as has been held repeatedly by the United States Supreme Court with respect to the crime of conspiracy as defined by *Title 18, U. S. C., Section 88*:

“The conspiracy is the offense which the statute defines without reference to whether the crime which the conspirators have conspired to commit is consummated.”

Williamson v. United States, 207 U. S. 425, 447 (1908).

Thus a person may be guilty of conspiring to commit a certain act although, at the same time, he may be incapable of committing that act.

United States v. Rabinowich, 238 U. S. 78, 85-86 (1915);

Williamson v. United States, 207 U. S. 425, 447 (1908);

United States v. Holte, 236 U. S. 140, 144 (1915).

This Honorable Circuit Court, in an appeal from a conviction for conspiring to impersonate an officer, pointed out:

“As to the first, or conspiracy count, the question of whether or not the appellants actually represented themselves as United States officers is not material. To sustain the conspiracy count it was necessary for the government to prove only that the accused entered into an agreement so to represent themselves, and that, in furtherance of that agreement, they committed one of the overt acts charged in the indictment.”

Heskett v. United States, 58 Fed. (2d) 897, 902 (C. C. A. 9th, 1932), cert. den. 287 U. S. 643 (1932).

See also:

Brown v. United States, 43 Fed. (2d) 906, 907 (C. C. A. 9th, 1930).

“A criminal conspiracy to possess intoxicating liquor or in some other respect to violate the National Prohibition Act may be complete without the consummation of such other substantive offense.”

Thus, although the evidence adduced at the trial in this case may not have convinced the jury that appellant Goodman himself exported the diamonds without a license, it may have, and from the verdict it appears that it did, satisfy the jury that Goodman was engaged in a conspiracy which had for its object such exportation.

See:

Middleton v. United States, 49 Fed. (2d) 538, 540 (C. C. A. 8th, 1931);

Allen v. United States, 89 Fed. (2d) 954, 955 (C. C. A. 4th, 1937);

Dealy v. United States, 152 U. S. 539, 547 (1894);

United States v. Britton, 108 U. S. 199, 204 (1883).

It may further be conceded, as appellant points out in his brief (pp. 23-25), that a trial jury may not infer guilt of a defendant from "pure conjecture," and that circumstantial evidence, in order to support a verdict of guilty, must be consistent with guilt and inconsistent with every reasonable hypothesis of innocence. For these principles appellant correctly cites:

United States v. Ross, 92 U. S. 281, 284 (1875);

Dahly v. United States, 50 Fed. (2d) 37, 43 (C. C. A. 8th, 1931);

Kennedy v. United States, 44 Fed. (2d) 131 (C. C. A. 9th, 1930);

Brown v. United States, 16 Fed. (2d) 682, 685 (C. C. A. 1st, 1926).

However, these same authorities clearly indicate that circumstantial evidence, where it *is* inconsistent with every reasonable hypothesis of innocence and consistent with guilt, is sufficient to sustain a conviction for conspiracy.

The chief contention of the appellant in this respect is that the conspiracy, which was proved at the trial, was merely a conspiracy to export the diamonds to Japan, and not a conspiracy to export *without a license* (Appellant's Brief 14-29). However, turning to the record, we find abundant testimony and evidence fairly tending to show that the conspiracy was to export "*without a license*," and not merely to export.

In the first place it was stipulated that none of the defendants had a license authorizing or permitting him to export industrial diamonds from the United States, as required by law [R. 19]. Moreover, it was further stipulated that neither Keeler nor *Goodman* had a license to export industrial diamonds [R. 71].

The only purpose to be served by the purchase of the industrial diamonds through Goodman by Takahashi was exportation to Japan. Takahashi told Goodman this in a conversation he had with him in the former's home in June, 1941, stating that he would like to purchase diamonds to fill an order from Japan [R. 20]. Goodman said he would be able to supply them [R. 21-22].

Ten days later Takahashi told Keeler in the presence of Goodman, at the Musto-Keenan Co., that he had received an order from Japan for diamonds and he gave Keeler the name of the parties that sent him the order from Japan. This, too, occurred in front of Goodman [R. 24].

In addition Takahashi had a conversation with Keeler about the quality of the diamonds, Goodman being present. Takahashi told them that he had "received letters quite a bit from Japan in which they referred quite a lot to the quality." He further told them that "the demand that was made by Japan was that they wanted extra good quality" [R. 30-31].

The first time he learned that an export license was necessary was when he gave Goodman the list of merchandise that he wanted to obtain for export [R. 37]. Takahashi knew that he could not send industrial diamonds to Japan and for that reason asked Goodman to get an export license for him [R. 37].

Goodman had been associated in a company with Takahashi up to March 27, 1941, only two months before the beginning of the conspiracy charged here, and he knew that Takahashi was exporting various kinds of merchandise to Japan in 1939 [R. 106]. Consequently, Goodman certainly had knowledge that the only purpose for the purchase of the industrial diamonds was to export them to Japan. He knew, further, that it was necessary to have a license in order to export industrial diamonds, because he told Takahashi he would try to get him a license [R. 21].

Goodman knew that Takahashi had just come from Japan at the time he was approached about the purchase of diamonds, and he knew that there was an embargo on shipments to Japan [R. 112]. His only excuse is that "He didn't think a thing about there being any law violating involved" [R. 112].

The fact that Takahashi told Keeler and Goodman that there was an order from Japan for diamonds is corroborated by Takizawa [R. 47].

Nakauchi received industrial diamonds in three packages in September, 1941, in Goodman's office, there being present Takahashi, Takizawa, Keeler and Goodman [R. 51-52]. Moreover, he received other diamonds from Takizawa in July, 1941, and took them to San Francisco in a portable phonograph, traveling there with a friend, who was going back to Japan. He left the diamonds in a hotel room in San Francisco [R. 52-53].

Goodman signed a statement for McCormick, an F. B. I. man, in which he admitted that at one time, in either July, August or September of 1941, Takahashi had told him that he could not pay for the diamonds "until the ship gets in." On another occasion Takahashi told him "I will pay your commissions when the boat arrives" [R. 66].

Keeler admitted that the orders which were being sent in through Goodman by the Japanese, and which were being filled by him, Keeler, in the period from July to September, 1941, were the largest amounts of diamonds that had ever been sold in the history of the company [R. 94]. Moreover, Keeler admitted that up to that time he had never sold any industrial diamonds to Japanese. He asked "Goodman or [sic!] the Japanese what they were going to use the diamonds for," because he knew at that time that a proclamation had been issued by the President against exporting industrial diamonds without a license. But he claims his suspicions were not aroused, even though the sales of diamonds kept on increasing until September 16th, when the largest order was put through [R. 95].

It is further argued by the appellant (Appellant's Brief, 30-33) that under the doctrine laid down by the United States Supreme Court in *United States v. Falcone*, 311 U. S. 205 (1940), a directed verdict should have been entered holding Goodman not guilty.

Of course, it is well known that the settled doctrine in the Ninth Circuit for many years had been that, where the accused appears to have been in fact more closely connected with the buyer's crime than merely as a seller of goods which the seller knew would be used by the buyer in furtherance of the commission of a conspiracy, in such case the accused is guilty of participation in the conspiracy.

Pattis v. United States, 17 Fed. (2d) 562 (C. C. A. 9th, 1927);

Vukich v. United States, 28 Fed. (2d) 666, 669 (C. C. A. 9th, 1928);

Borgia v. United States, 78 Fed. (2d) 550, 555 (C. C. A. 9th, 1935).

This same rule had been laid down by the Seventh Circuit as well.

Anstess v. United States, 22 Fed. (2d) 594 (C. C. A. 7th, 1927);

Hubinger Co. v. United States, 64 Fed. (2d) 772 (C. C. A. 7th, 1933).

It had been followed in the Sixth Circuit.

Rudner v. United States, 281 Fed. 516, 520 (C. C. A. 6th, 1922).

On the other hand the Second and Fifth Circuits had held otherwise, and to the effect that the seller or supplier of goods, in order to be held guilty of participation in

the conspiracy, had to promote the venture itself in the sense of becoming an actual aider, abettor, and participant in the conspiracy.

Young v. United States, 48 Fed. (2d) 26 (C. C. A. 5th, 1931);

United States v. Peoni, 100 Fed. (2d) 401 (C. C. A. 2d, 1938);

United States v. Falcone, 109 Fed. (2d) 579 (C. C. A. 2d, 1940).

When the *Falcone Case* came up for review before the Supreme Court on certiorari the Government did not argue that conviction for conspiracy can rest on proof alone of knowingly supplying an illicit distiller who is in a conspiracy with others. However, it did contend that one who, with knowledge of a conspiracy to distill illicit spirits, sells material to a conspirator, knowing that they will be used in the distilling, is himself guilty of the conspiracy. The Supreme Court pointed out that this argument would not be considered on the merits, because the evidence in the trial of the *Falcone Case* showed—

“* * * only that respondents or some of them knew that the materials sold would be used in the distillation of illicit spirits, and fell short of showing respondents’ participation in the conspiracy or that they knew of it.”

United States v. Falcone, 311 U. S. 205, 208 (1940).

Because such were the facts and the evidence at the trial of the cause, the Supreme Court properly held that—

“* * * one who *without more* furnishes supplies to an illicit distiller is not guilty of conspiracy even

though his sale may have furthered the object of a conspiracy to which the distiller was a party but of which the supplier had no knowledge. *On this record we have no occasion to decide any other question.*" (Italics supplied.)

Id., pp. 210-211.

The inapplicability of the *Falcone Case*, therefore, to the question of the appellant Goodman's participation in the conspiracy here charged is manifest. Here, Goodman was not a mere supplier "*without more.*" Moreover, the facts and the evidence at the trial in this cause did not show *only* that the supplier "knew that the materials sold would be used" in the illicit purpose; and certainly the facts and evidence did not fall short of showing the appellant's participation in the conspiracy or that he knew of it.

It is not necessary at this point for the Government to reiterate the numerous facts brought out not only by the testimony of Takahashi, Takizawa and Nakauchi, but also by the admissions of Keeler and Goodman, in order to show that Goodman, far from being a mere supplier of goods, was actually an active participant who engaged in the conspiracy with full knowledge of its purpose, lending assistance and aid in numerous ways and on numerous occasions throughout the four or five months' period. The Government, therefore, merely refers this Honorable Circuit Court to its outline of the evidence contained in the Statement of Facts, not only in this brief, but in the Appellant's Brief, and to the discussion of the evidence showing that the conspiracy was clearly one to export industrial diamonds *without a license*.

II.

**The District Court Did Not Err in Overruling the
Objections and Denying the Motions to Strike
With Respect to the Testimony of the Witness
Nakauchi.**

The appellant attacks the trial court's ruling in admitting the testimony of the witness Nakauchi into the evidence on the ground that there was no independent testimony other than that of Nakauchi tending to show that a conspiracy existed and, hence, that Nakauchi's testimony was hearsay and not admissible. Assignment of Error of Goodman IV [R. 135-137] (Appellant's Brief, 33-34).

It is true that "a conspiracy is not an omnibus charge, under which you can prove anything and everything, and convict for the sins of a lifetime."

Terry v. United States, 7 Fed. (2d) 28 (C. C. A. 9th, 1925).

However, a wide latitude is permitted to the prosecution in proving the essential elements of the conspiracy,

Metzler v. United States, 64 Fed. (2d) 203, 207 (C. C. A. 9th, 1933),

and the unlawful scheme can be shown by declarations and conduct of the parties as well as by numerous other circumstances which lead to the logical inference of common purpose and design.

Cummings v. United States, 15 Fed. (2d) 168, 169 (C. C. A. 9th, 1926);

Coates v. United States, 59 Fed. (2d) 173, 174 (C. C. A. 9th, 1932);

Marino v. United States, 91 Fed. (2d) 691-698 (C. C. A. 9th, 1937), cert. den. 302 U. S. 764 (1937).

When the offense charged is a conspiracy and one of the co-conspirators engages in activities and makes declarations after the conspiracy has been formed and in furtherance of its objects, those acts and declarations are admissible against all of the co-conspirators, regardless of whether they had knowledge of those specific acts and declarations or not. By joining in the scheme the co-conspirators are tainted by it, and by the act of joining they adopt as their own all of the acts and declarations which have theretofore been made in pursuance of its purpose.

Logan v. United States, 144 U. S. 263, 309 (1892);

Brown v. United States, 150 U. S. 98 (1893);

Coates v. United States, 59 Fed. (2d) 173, 174 (C. C. A. 9th, 1932).

It is not necessary that a co-conspirator know all the members of the conspiracy or the part which each played or was to play. He may join it at any point in its progress and be held responsible for all that may be or has been done.

United States v. Manton, 107 Fed. (2d) 834, 848 (C. C. A. 2d, 1938);

Laska v. United States, 82 Fed. (2d) 672, 677 (C. C. A. 10th, 1936), cert. den. 298 U. S. 689 (1936).

The testimony of Nakauchi, of course, tended to show that a conspiracy existed and that the conspiracy was to export industrial diamonds to Japan without a license. He testified, as pointed out above, that he received a number of industrial diamonds from Takizawa, one of

the co-conspirators; that in July, with a friend who was going to Japan, he went to San Francisco, taking the diamonds with him in a portable phonograph; and that he left them in a hotel room in San Francisco [R. 51-53].

If this were the only testimony which the Government adduced at the trial on the question of the existence of the conspiracy, then undoubtedly, under the doctrine of the *Tofanelli*, *Bartkus*, and *Mayola Cases*, such testimony of Nakauchi would have been hearsay and not admissible as against any of the co-conspirators except Nakauchi.

Tofanelli v. United States, 28 Fed. (2d) 581 (C. C. A. 9th, 1928);

Bartkus v. United States, 21 Fed. (2d) 425 (C. C. A. 7th, 1927); and

Mayola v. United States, 71 Fed. (2d) 65 (C. C. A. 9th, 1934).

However, without going into the details of the testimony of each of the other witnesses, it is sufficient to point out that there is a plethora of testimony adduced through them by the Government, all of which tends to show the existence of the conspiracy; participation in it by all of the defendants, including the appellant Goodman; and the fact that it was a conspiracy formed for the purpose of exporting industrial diamonds *without a license*. See the testimony of the following: Takahashi [R. 20, 23-25, 27, 30-33]; Takizawa [R. 45-49]; McCormick [R. 64-67]; LeGrand [R. 76-80]; Keeler [R. 87-91], and Goodman [R. 99-106]. Thus not only by the testimony of witnesses other than Nakauchi is the existence of the conspiracy fully proved, but even by the admissions and signed statements of two of the co-conspirators, namely, Keeler and the appellant Goodman himself.

It is settled law, not open to challenge at this late date, that all declarations and acts made and done by a conspirator after the formation of the conspiracy and in furtherance of its object are always admissible against each and every of the co-conspirators, whether they have joined the conspiracy at the time of the statements or entered it after the statements were made.

Wiborg v. United States, 163 U. S. 632, 657-658 (1896);

United States v. Manton, 107 Fed. (2d) 834, 848 (C. C. A. 2d, 1938);

Van Riper v. United States, 13 Fed. (2d) 961, 967 (C. C. A. 2d, 1926), cert. den. 273 U. S. 702 (1926);

Ford v. United States, 10 Fed. (2d) 339 (C. C. A. 9th, 1926), cert. den. 273 U. S. 593 (1927);

Marino v. United States, 91 Fed. (2d) 691, 696 (C. C. A. 9th, 1937), cert. den. 302 U. S. 764 (1937);

Coates v. United States, 59 Fed. (2d) 173, 174 (C. C. A. 9th, 1932);

Levine v. United States, 79 Fed. (2d) 364, 370 (C. C. A. 9th, 1935);

Levey v. United States, 92 Fed. (2d) 688, 691 (C. C. A. 9th, 1937), cert. den. 303 U. S. 639 (1938).

Consequently it is impossible to see how it is claimed that the testimony of the witness Nakauchi was hearsay. It follows that the trial court did not err in overruling the objections and motions to strike with respect to that testimony.

III.

The Reference Made to the Testimony of the Witness Nakauchi by the District Court and by the United States Attorney Did Not Constitute Prejudicial and Reversible Error.

The appellant seems to contend that in the closing argument government counsel and the trial court committed reversible error in referring to the trip made to San Francisco by Takizawa. Assignment of Error V [R. 137-140] (Appellant's Brief, 24-25, 33-34). The contention seems to be that since Nakauchi's testimony was not admissible, inasmuch as there was no independent testimony of the conspiracy, any comment on it by the United States Attorney or by the trial court is reversible error. The point, however, is not argued at any length in the appellant's brief and, since it stands or falls with the admissibility of Nakauchi's testimony, there would appear to be no reason for arguing it here.

It is clear that the control of the arguments of counsel made to the jury at the conclusion of the trial is largely a matter of discretion of the trial court. That discretion will not be interfered with unless so abused as to clearly cause prejudicial error.

Hyde v. United States, 35 App. D. C. 451 (1910),
affirmed 225 U. S. 347 (1912).

Moreover, comments by the prosecuting attorney made in argument to the jury, where based on evidence properly admitted, as tending to establish the conspiracy are within proper scope of the argument.

Richards v. United States, 175 Fed. 911 (C. C. A. 8th, 1909).

Counsel for the Government may make any argument which is based on evidence or may be reasonably inferred therefrom.

Malone v. United States, 94 Fed. (2d) 281 (C. C. A. 7th, 1938), cert. den. 304 U. S. 562.

From this it follows, as has been held by this Honorable Circuit Court, that error cannot be predicated upon an argument which is based on testimony and such reasonable inferences as may be drawn therefrom.

Borgia v. United States, 78 Fed. (2d) 550 (C. C. A. 9th, 1935), cert. den. 296 U. S. 615.

In the instant cause it is clear that if the testimony of Nakauchi was admissible, and it was so shown to be by the Government in Point II of its brief herein, the comment by the prosecuting attorney thereon was eminently proper. It was a true and fair statement of the evidence as related in the testimony of Nakauchi.

It is true, of course, that the court, in commenting upon the evidence, inadvertently used the name "Takizawa" instead of "Nakauchi" [R. 117]. However, any false impression, if such there was created, was immediately thereafter corrected by the prosecuting attorney, who emphasized that the testimony was that of Nakauchi and not of Takizawa [R. 117].

In the view of the Government therefore, since the testimony of Nakauchi was admissible, the comments made by the court and prosecuting attorney were not only incapable of causing prejudicial error but, by the very

nature of things, proper in all respects. For which reason the Government submits that the reference made to the testimony of witness Nakauchi by the trial court and Government counsel did not constitute prejudicial or reversible error.

Conclusion.

Wherefore it is respectfully submitted that the judgment of conviction with respect to the appellant Goodman should be affirmed.

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No. 9989

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

HYMAN HOWARD GOODMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S REPLY BRIEF.

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TABLE OF AUTHORITIES CITED.

CASES.

	PAGE
Gung You v. Nagle, 9 Cir., 34 Fed. (2d) 848.....	6
Hann v. Venetian Blind Corp., 9 Cir., 111 Fed. (2d) 455.....	7
Interstate Circuit v. United States, 306 U. S. 208.....	6
Mayola v. United States, 9 Cir., 71 Fed. (2d) 65.....	10
Oras v. United States, 9 Cir., 67 Fed. (2d) 463.....	5
Simpson v. United States, 4 Cir., 11 Fed. (2d) 591.....	5
United States v. Falcone, 109 Fed. (2d) 579, 311 U. S. 205....	
.....	8, 9

MISCELLANEOUS.

Export Control Regulations and Export Control Schedule No. 1, published by the Administrator of Export Control, effective April 15, 1941.....	2
---	---

Appendix:

United States v. Falcone, 109 Fed. (2d) 579.....	11
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APPELLANT'S REPLY BRIEF.

I

We fully agree with the Government's argument that the verdict should be affirmed if there was substantial and competent evidence to sustain it, for this court will not go into the weight of the evidence.

However, we submit that the Government has utterly failed to meet the real issue in this case, *i. e.*, was there any substantial and competent evidence to sustain the verdict?

From the outset, in the statement of facts in our main brief, we have taken the view that the evidence must be looked at in a light most favorable to the Government. The Government concedes that that statement of facts is fair and complete (Government's Brief p. 4). Nevertheless, the Government has failed to point to a single fact or circumstance, upon which a finding could be based that

there was a conspiracy or an intent to export the diamonds without a license.

We have conceded all along that the evidence shows that the diamonds were being purchased, by persons who had no export license, for the purpose of being exported to Japan. However, there was nothing criminal or unlawful about that.

The Government states (Government's Brief p. 4) that appellant admitted that there was sufficient evidence "to show a combination, conspiracy or agreement to purchase industrial diamonds for the purpose of exportation to Japan." The facts were admitted, but not that there was a "conspiracy." There was nothing conspiratorial about any of the transactions in which Goodman participated. They were open and fully legitimate.

The Statute, Presidential Proclamation and the Regulations (quoted on pp. 14-17 of our main brief) did not require any license for the purchase or sale of diamonds intended for export. A license had to be obtained only by the actual exporter but not before the clearing of the goods through the port of exit.*

*Export Control Regulations and Export Control Schedule No. 1, published by the Administrator of Export Control, effective April 15, 1941 (which dealt with export licenses) provided:

"4. WHO MAY APPLY.

"a. *Applications may be made by a corporation partnership, individual, or their duly authorized agent, who is in fact the exporter of the goods, except when the proposed shipment consists of unused metal working machinery, in which case applications must be made by the manufacturer* * * *

"5. WHEN TO APPLY.

"a. *Applications may be made at any time prior to the clearing of the goods through the port of exit."*

There is no question that in a conspiracy it is immaterial whether the crime was actually consummated. Consequently, it was not necessary for the Government to prove that the diamonds left the United States for Japan without a license. However, and this is the crux of the case, it was necessary to show that an actual intent was shared by Goodman and one or more other persons to export them without first obtaining a license. There is not a scintilla of evidence to show such intent by anyone.

It is needless again to discuss all of the facts, after the full factual resume in our main brief. We wish, however, to correct the following misstatement in the Government's brief (p. 5):

"After the first shipments had been made to Japan Takahashi told Goodman that he had received letters from Japan referring to the quality of the industrial diamonds and demanding extra good quality [R. 30-31]."

There is no evidence whatsoever that any shipments were ever made to Japan. Pages 30-31 of the record, to which this paragraph refers, contain no such testimony. In our main brief (App. Br., pp. 26-27) we copied and fully discussed this evidence by Takahashi, but in view of this misstatement we beg leave to repeat it herein. Takahashi's testimony was as follows [R. 30-31]:

"Q. Did you ever have a conversation with Mr. Keeler about hearing from anyone in Japan regarding diamonds that had been sent? A. No, I did not.

The Witness: I discussed with Keeler the quality of the diamonds and told him I didn't think the quality of the first sample was very good. I spoke occasionally about the quality and that the price was very high.

Q. Did you say anything to him about anyone advising you as to the quality or the price? A. I told him that I had received letters quite a bit from Japan in which they referred quite a lot to the quality; I told him that.

Q. What did you tell him about those letters that you had received concerning the quality? A. The demand that was made by Japan was that they wanted extra good quality; and I told him, not being experienced, even though not being experienced in diamonds, I didn't think the quality was very good.

Q. Was anyone else present when you told Mr. Keeler that? A. Mr. Goodman was there, and Mr. Takizawa was there at times."

Takahashi thus squarely testified that he had not heard from anyone in Japan regarding the sending of diamonds, but merely told Keeler and Goodman that he received letters that Japan wanted good quality. There is therefore nothing even remotely indicating that any shipments had been made to Japan.

Furthermore, even if the letters to Takahashi from Japan had actually stated that shipments of diamonds had been made, they would be purely hearsay statements to Takahashi by his Japanese correspondent. The letters would then have no value as evidence that shipments were actually made.

It is true that in conspiracy cases circumstantial evidence must frequently be resorted to by the Government, but this is because

“In conspiracy cases direct evidence of conspiracy is rarely obtainable.”

Simpson v. U. S., 4 Cir., 11 Fed. (2d) 591, 592.

In this case, however, the alleged main conspirators, *i. e.*, Takahashi, Takizawa and Nakauchi, pleaded guilty and as Government witnesses answered fully all questions propounded to them. Direct evidence was thus available in this case.

Why did not the Government prove through these witnesses that they intended to export the diamonds without a license and that Goodman knew about such intent?

On the contrary, Takahashi, who was the only one to be questioned about the matter, testified that the intention was to obtain an export license [R. 21, 37].

The Government never attempted to show, through its own cooperative witnesses, that at any time thereafter either Takahashi or the others, with Goodman's knowledge, changed their minds and conspired to export the diamonds without first obtaining a license.

Oras v. U. S., 9 Cir., 67 F. (2d) 463, quoted on p. 24 of our main brief.

As we anticipated, the Government refers to Nakauchi's testimony about his trip to San Francisco with a friend who was returning to Japan and about a package which he left at a hotel, as a probative element in its case. Our main brief (App. Br., pp. 20-25) fully discussed this in-

cident and showed that not only was the evidence inadmissible, but also that it was entirely innocuous and sustained no part of the Government's case.

Assuming *arguendo* that this unidentified friend of Nakauchi did thereafter export diamonds to Japan, of which there is no evidence, it must be presumed—in the absence of any evidence to the contrary and under the presumption of innocence (*Gung You v. Nagle*, 9 Cir., 34 Fed. (2d) 848, 850)—that he had an export license and exported the diamonds lawfully.

It is noteworthy that Nakauchi, a Government witness, was never asked by the Government about the name or identity of this friend who was returning to Japan. If, as argued by the Government, the jury could infer that Nakauchi's departing friend took the diamonds to Japan, then should not the Government have established his name and the fact that he had no license?

Would not that evidence have been so much more potent than the conjecture upon which the Government is now relying?

We submit that this case comes within the principle laid down by the Supreme Court in *Interstate Circuit v. United States*, 306 U. S. 208, 226, that:

“The production of weak evidence when strong evidence is available can lead only to the conclusion that the strong would have been adverse. *Clifton v. United States*, 4 How. 242, 247. Silence then becomes evidence of the most convincing character.”

The same thought was recently expressed by this court in *Hann v. Venetian Blind Corp.*, 9 Cir., 111 Fed. (2d) 455, 459, as follows:

“* * * when there is material testimony which would establish a fact in issue in the present ability of the litigant to present and he fails to do so, and fails to offer a reasonable excuse for such failure, the presumption follows that such testimony, if presented would be against such party * * *”

We conclude this portion of our reply with the repetition that (a) the evidence shows merely the purchase and sale of diamonds to be exported to Japan, by persons who had no export license, but who intended to obtain a license before exportation, (b) the Government has failed to point out a single evidentiary fact or circumstance from which it could be inferred that there was an intent by anybody to export the diamonds without a license, and (c) there is no proof in the record before this court of any conspiracy or the commission of any crime by any of the defendants, despite the fact that some of them pleaded guilty for reasons best known to themselves.

II.

Even if it is assumed—without conceding—that there is any evidence in the record that Takahashi or the others intended to export the diamonds without a license, the Government has failed to point out any evidence that Goodman knew about such a criminal intent.

III.

Our argument is predicated primarily upon the contentions (1) that there is no evidence of a conspiracy or crime on the part of any of the defendants and (2) that if the court should hold that there is evidence that a crime was intended by Takahashi or the other Japanese defendants, there is no evidence that Goodman knew about it.

If this court will agree with either of these contentions then Goodman's conviction should be reversed and it becomes unnecessary to consider the effect of the case of *U. S. v. Falcone*, 109 Fed. (2d) 579, 311 U. S. 205, which is discussed in the latter part of our main brief. It is only in the event that this court should overrule our primary argument and hold that there is evidence of both the commission of a crime and of Goodman's knowledge of the criminal intent, that it becomes important to determine the question whether a supplier of innocent goods is guilty of conspiracy because he knows that the buyer intends to use them for illicit purposes.

The Government argues (Government's Brief, p. 27) that *U. S. v. Falcone* does not apply for the reason that Goodman was more than a supplier of goods and actively participated in a conspiracy. The evidence is all to the contrary.

Goodman's various activities were confined solely to supplying diamonds to Takahashi. Once the diamonds were purchased by Takahashi, Goodman had nothing further to do with them.

Goodman's acts were therefore in no way different from the acts of the five defendants in the case of *U. S. v. Falcone, supra*, whose convictions were reversed.

The full opinion of the Supreme Court in *U. S. v. Falcone* is printed as Appendix 1 in our main brief (pp. 37-40). However, the opinion of the Circuit Court of Appeals (109 Fed. (2d) 579) sets forth the facts in greater detail. We have therefore copied the pertinent part of the opinion of the Circuit Court as an appendix to this reply brief [pp. 11-16]. Upon examination of the latter opinion the similarity between Goodman's acts in this case and the acts of the five defendants in that case will be apparent.

We therefore submit that Goodman's conviction should be reversed, under the authority of *U. S. v. Falcone*, even if this court should hold that there is evidence of a conspiracy by Takahashi and others to export the diamonds without a license.

IV.

The Government attempts to justify the admission of Nakauchi's testimony about the San Francisco trip, which was clearly hearsay and incompetent, on the ground that it related to acts and declarations of co-conspirators (Government's Brief, pp. 28-31).

The fallacy with that argument is that there is no independent evidence that a conspiracy existed, which is a prerequisite to the admission of acts and declaration of

co-conspirators (*Mayola v. U. S.*, 9 Cir., 71 Fed. (2d) 65, 67, discussed on p. 24 of our main brief).

V.

We respectfully submit that the Government's brief has failed to show any evidence in the record to sustain Goodman's conviction and that the judgment appealed from should be reversed.

Respectfully submitted,

LEO GOODMAN,

M. SEATON COHEN,

Attorneys for Appellant.

MAX BERGMAN,

Of Counsel.

APPENDIX.

U. S. v. Falcone, 109 F. (2d) 579.

L. HAND, *Circuit Judge*.

These appeals are from convictions for a conspiracy to operate illicit stills. There were originally sixty-eight defendants, but the appeals before us concern only eight, which may be divided into two groups: one those of the appellants, Salvatore and Joseph Falcone, Alberico, John and Nicholas Nole; the other, of Grimaldi, Graniero and Soldano. Two other defendants, Milozzo and Melito, have withdrawn their appeals. The second group were actual distillers; the first supplied them and other distillers with sugar, yeast, and cans, out of which the alcohol was distilled, or in which it was sold. The evidence disclosed that in the year 1937 and 1938 within a radius of fifty miles from the City of Utica some twenty-two illicit stills had been set up, which were in each case to some extent operated after the same pattern; that is to say, real property was bought or leased, motor cars were registered, and applications for electric and water services were made, all in fictitious names; the equipment and materials were bought from the same persons; and the distillers frequented the same cafe or saloon, where they talked together. Grimaldi, Graniero and Soldano were all operators of one or more stills; the evidence of their guilt was ample; and they complain only of the manner in which the trial was conducted. We shall reserve their objections till the end, because the most serious matter is as to the sufficiency of the evidence to support the verdict against the others.

The case against Joseph Falcone was that during the year 1937 he sold sugar to a number of grocers in Utica,

who in turn sold to the distillers. He was a jobber in Utica, and bought his supply from a New York firm of sugar brokers; between March first and September 14, 1937, he bought 8,600 bags of sugar of 100 pounds each, which he disposed of to three customers: Frank Bonomo & Company, Pauline Aiello, and Alberico and Funicello, all wholesale grocers in Utica. Some of the bags in which this sugar was delivered were later found at the stills, when these were raided by the officials; and Falcone was seen on one occasion assisting in delivering the sugar at Bonomo's warehouse, when a truckload arrived. His business in sugar was far greater while the stills were active than either before they were set up, or after they were seized, and we shall assume that the evidence was enough to charge him with notice that his customers were supplying the distillers. The evidence against Salvatore Falcone went no further than to show in various ways that he helped his brother in purchase of sugar during the period in question; there is really nothing to show that he knew its eventual destination. However, since in the view we take of the law he was equally innocent if he did, in disposing of his case we shall assume that he did know. Alberico was a member of the firm of Alberico and Funicello who, as we have just said, were buyers from Joseph Falcone. Alberico's purchases and sales of sugar also varied with the activity of the stills. In the first three months of 1937, when there were five or six of these operating in or about Utica, his purchases ran up to over a half-million pounds; after they had been raided in April, his business fell off to very little; when they became active again in September, his purchases rose again. A like correspondence, though less exact, was proved for the early part of the year 1938. A jury might

also have taken the conversation which he had with one of the distillers, Morreale, as evidence of his knowledge of the kind of business that he was supplying. While the stills were active, Alberico also did a large business in five-gallon cans which he sold direct to the distillers. Many cans sold by him were found at the stills when they were raided. The evidence against Nicholas Nole consisted of his sales of yeast and cans to the distillers. The prosecution proved that in the spring of 1937 he had ordered and received shipments of imported yeast through a forwarding company of which he was the owner; and that in July and August of that year he bought of the Atlantic Yeast Company 8,300 pounds of yeast packed in wrappers, made expressly for the "Acme Yeast Company" a name under which he did business by virtue of a certificate, taken out for him by a cousin. Many of these wrappers were found at several of the stills. The case against John Nole depended upon the assistance which he gave his brother, Nicholas, and upon his being distributor for the National Grain Yeast Company for Utica during the years 1937 and 1938, a number of whose wrappers were found at the stills. Again we shall assume that the Noles knew that Nicholas's customers were illicit distillers.

In the light of all this, it is apparent that the first question is whether the seller of goods, in themselves innocent, becomes a conspirator with—or, what is in substance the same thing, an abetter of—the buyer because he knows that the buyer means to use the goods to commit a crime. That came up a number of times in circuit courts of appeal while the Eighteenth Amendment was in force, and the answer was not entirely uniform. The first case we have found is *Pattis v. United States*, 9 Cir., 17 F. 2d

562, where, although the accused appears to have been in fact more closely connected with the buyer's crime than merely as a seller, the court affirmed a charge to the jury that he was guilty if he merely had notice of the future destination of the goods. That appears to be the settled doctrine in that circuit. *Vukich v. United States*, 9 Cir., 28 F. 2d 666, 669; *Borgia v. United States*, 9 Cir., 78 F. 2d 550, 555. The same is true of the Seventh Circuit. *Anstess v. United States*, 7 Cir., 22 F. 2d 594; *Hubinger Company v. United States*, 7 Cir., 64 F. 2d 772. And of the Sixth. *Rudner v. United States*, 6 Cir., 281 F. 2d 516, 520. The Fifth has, however, held otherwise, though by a divided court, *Young v. United States*, 5 Cir., 48 F. 2d 26. In that case the judges differed because of their interpretation of *Edenfield v. United States*, 273 U. S. 660, 47 S. Ct. 345, 71 L. Ed. 827, which, on the authority of *United States v. Katz*, 271 U. S. 354, 46 S. Ct. 513, 70 L. Ed. 986, reversed a conviction upon a count for conspiracy to manufacture liquor without a license. The indictment also contained a count for conspiracy to manufacture liquor contrary to the National Prohibition Law, 41 Stat. 305, and the conviction on this the court did not disturb; the question was whether in doing so it had held that the mere sale of materials for making a still, and of sugar and meal to make liquor, was enough to convict. The opinion below (*Edenfield v. United States*, 5 Cir., 8 F. 2d 614) indicated that there had been nothing more to hold the seller, but when the same court in *Young v. United States*, *supra*, (5 Cir., 48 F. 2d 26), came to consider the effect of the reversal, the majority said that there had in fact been much more; i. e., that the accused had taken part in setting up the stills, and in selling the liquor after it was made. We do not think, therefore, that

Edenfield v. United States, *supra*, (273 U. S. 660, 47 S. Ct. 345, 71 L. Ed. 827), should be regarded as passing upon the point. We are ourselves committed to the view of the Fifth Circuit. United States v. Peoni, 2 Cir., 100 F. 2d 401. In that case we tried to trace down the doctrine as to abetting and conspiracy, as it exists in our criminal law, and concluded that the seller's knowledge was not alone enough. Civilly, a man's liability extends to any injuries which he should have apprehended to be likely to follow from his acts. If they do, he must excuse his conduct by showing that the interest which he was promoting outweighed the dangers which its protection imposed upon others; but in civil cases there has been a loss, and the only question is whether the law shall transfer it from the sufferer to another. There are indeed instances of criminal liability of the same kind, where the law imposes punishment merely because the accused did not forbear to do that from which the wrong was likely to follow; but in prosecutions for conspiracy or abetting, his attitude towards the forbidden undertaking must be more positive. It is not enough that he does not forego a normally lawful activity, of the fruits of which he knows that others will make an unlawful use; he must in some sense promote their venture himself, make it his own, have a stake in its outcome. The distinction is especially important today when so many prosecutors seek to sweep within the drag-net of conspiracy all those who have been associated in any degree whatever with the main offenders. That there are opportunities of great oppression in such doctrine is very plain, and it is only by circumscribing the scope of such all comprehensive indictments that they can be avoided. We may agree

that morally the defendants at bar should have refused to sell to illicit distillers; but, both morally and legally, to do so was *toto coelo* different from joining with them in running the stills. State ex rel. Dooley v. Coleman, 126 Fla. 203, 170 So. 722, 108 A. L. R. 326, accords with this view.

For these reasons the prosecution did not make out a case against either of the Falcones, Alberico, or John Nole; and this is especially true of Salvatore Falcone. As to Nicholas Nole the question is closer, for when he began to do business as the "Acme Yeast Company", he hid behind the name of a cousin, whom he caused to swear falsely that the affiant was to do the business. Yet it seems to us that this was as likely to have come from a belief that it was a crime to sell the yeast and the cans to distillers as from being in fact any further involved in their business. It showed a desire to escape detection, and that was evidence of a consciousness of guilt, but the consciousness may have as well arisen from a mistake of law as from a purpose to do what the law in fact forbade. We think therefore that even as to him no case was made out.

(The remaining portion of the opinion has been omitted for the reason that it deals with other questions which are not pertinent to this case.)

No. 9989.

9

IN THE

United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

HYMAN HOWARD GOODMAN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

PETITION FOR REHEARING.

WM. FLEET PALMER,

United States Attorney,

LEO V. SILVERSTEIN,

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United States Post Office and Court House
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Attorneys for Appellee.

FILED

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TOPICAL INDEX.

	PAGE
Argument	8
Certificate of Counsel.....	10

TABLE OF AUTHORITIES CITED.

	PAGE
Ghadiali v. United States, 17 Fed. (2d) 236.....	9
Rendleman v. United States, 38 Fed. (2d) 779.....	9
Terry v. United States, 51 Fed. (2d) 49.....	9

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IN THE

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HYMAN HOWARD GOODMAN,

Appellant,

vs.

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Appellee.

PETITION FOR REHEARING.

*To the Honorable United States Circuit Court of Appeals
of the Ninth Circuit and to the Judges Thereof:*

This is a petition for rehearing after a decision by this Honorable Court reversing the conviction of appellant. The opinion of the Court was filed June 12, 1942.

I.

Appellee urges there was evidence in the record from which the jury could infer that the appellant knew the industrial diamonds in question were to be exported without a license.

Direct testimony of Takahashi, one of the defendants, who appeared as a witness for the government:

“I saw Goodman about the beginning of June of this year at my home on 58th street, Los Angeles.

My first conversation with him pertaining to industrial diamonds was at my home during June.

Q. Would you state what the conversation was?

A. I said that I had an order for diamonds from Japan and if I were able to fill that order, I said I would like to purchase them.” [R. 20.]

* * * * *

“Q. What was said in that conversation that you had with Mr. Goodman about obtaining a license?”

* * * * *

“A. I gave him the list, and I told him to obtain the license.

Q. What did he say? A. He said he would try.

Q. What list were you referring to? A. A number of articles on there. [20].

Q. Were there any articles or industrial diamonds on the list? A. Yes; that was also on there.” [R. 21.]

“I had a conversation with Goodman concerning the samples at my home. No one else was present. I said I did not think the quality of the merchandise was very good; the color wasn’t good. That is when we decided to go together to Keeler’s place. I first went to Musto-Keenan Co. about a week or ten days after I received the samples. I went with Goodman and met Keeler. In the presence of the three of us, I said I wanted to purchase some more diamonds. Keeler explained the diamonds to me and asked me what I was going to use them for.

Q. What did you say to him? [22.] A. I told him I did not know anything at all about diamonds;

but I gave him the name of the people that sent me the order from Japan.

Q. Did you tell him where they were going to?

A. I don't think I said anything at that time."

* * * * *

"Q. Did you say anything to him about the people who had requested you to get the diamonds? A. No, I did not.

Q. When did you first have a conversation with Mr. Keeler in which you told him where the diamonds were going to? A. I did not tell him definitely where they were going."

* * * * *

"Q. What did you say to Mr. Keeler? A. I said this: I told him that I had received an order from Japan for these diamonds, and I told him that I had myself had no experience with these diamonds or any diamonds; and I said I was going to trust Mr. Keeler entirely, and I asked him to take that responsibility and to go ahead with it.

Q. What did he say? A. He said that anything he would handle that I would not have to be afraid of losing any money on it.

Q. Now, was Mr. Goodman present when this conversation took place? A. Yes; he was always there with me." [R. 23-25.]

Cross-examination of Takahashi:

"Q. Now, then, you mentioned some letters from Japan. What letters did you get from Japan? A. I got all kinds of letters from Japan.

Q. Did you get any letters from Japan on industrial diamonds? A. Yes.

Q. When: How long ago? A. Also in July and August.

Q. They were written in Jananese to you, I suppose? A. Yes.

Q. You didn't show anything like that to Mr. Goodman, did you? [31.] A. No, I did not.

The Court: Did you tell him the contents of the letters?

The Witness: Yes.

The Court: What did you tell him?

By Mr. Cohen:

Q. What did you tell him about that? A. I told him that they referred to the quality.

Q. Did you ever tell Mr. Goodman the name of any Japanese company that you were doing business with?"

* * * * *

"The Witness: No, I never told him.

The Court: Did you tell him who you were buying the diamonds for?

The Witness: No. All I told him was that I was going to send it to Japan.

By Mr. Cohen:

Q. When did you tell him that? A. Right from the beginning.

Q. Was there any export order—did you know whether you could send diamonds to Japan then or

not? A. That is why I asked Mr. Goodman to get an export license for me.

Q. And did you know whether or not anybody ever had an export license at that time to send anything to Japan? A. I don't know anything at all about that.

Q. When was the first time the words 'export license' were ever mentioned to you? Wasn't it after you were arrested?

* * * * *

The Witness: No, it was not." [32.]

"Q. When was the first time that you learned that you had to get an export license? A. The first time that I gave Mr. Goodman the list of merchandise.

Q. Who told you then? Where did you get that information from? A. I do not know from any particular person that I heard it, but I knew that I had to have an export license.

Q. Well, where did you learn it? A. I don't remember." [R. 35-37.]

From a written statement of appellant, given to FBI Agents [R. 64-68]:

"I presumed H. H. G. that it was illegal to export diamonds without a license H. H. G. but I did not know whether or not Takahashi planned to export these industrial diamonds. Takahashi gave several different reasons for wishing to purchase diamonds. At one time in July, August or September, 1941, he told me, 'I cannot pay for H. H. G. the diamonds

until the ship gets in.' On another occasion during this period he said, 'I will pay you your commissions when the boat arrives.'" [R. 66.]

Direct examination of appellant:

"Takahashi never said to Keeler or myself that he intended to ship these diamonds to Japan, or that he had a customer in Japan to whom he intended to ship diamonds. [R. 102.]

I never entered into an agreement or understanding with Takahashi, Takizawa, Nakauchi, Keeler or anyone else to export [82] diamonds to Japan. I did not know that Takahashi had intentions of sending diamonds to Japan without a license. It was not discussed with me. Takahashi did not tell me that he had no license nor did he ask me to obtain one for him. I never attempted to obtain a license to export diamonds to Japan." [R. 105-106.]

Cross-examination of appellant:

"The Witness: I was associated in business with a company formed by Takahashi and known as the Tio Bussan Company. That company ceased doing business approximately March 27th of this year. I knew that Takahashi had been in the import-export business and that he had been established here for a number of years in some kind of curio store. I knew that Takahashi exported women's stockings a year or two ago, in the fall of 1939." [R. 106.]

"I never asked him what he had done with the diamonds or why he did not sell them. Takahashi did not say anything about a license." [R. 108.]

Redirect examination of appellant:

By Mr. Cohen:

“The Witness: In my statement where I said, ‘I presumed it was illegal to export diamonds,’ when he wrote that, he put that in. I tried to change the wording around so that it would mean that I presumed at the time. I had a splitting headache all night the night before.” [R. 112-113.]

Testimony of Takizawa, one of the defendants, who appeared as a witness for the government:

“Takahashi, Goodman, Keeler and myself met again at the same place and had a conversation. Takahashi said that the quality of the diamonds was not very good. Keeler answered that according to the price it was the best.

Q. Was anything else said? A. Mr. Takahashi said that there was a big order coming from Japan and he wanted Mr. Keeler to be very careful about the quality.

Q. Did Mr. Keeler say anything in response to that? A. He said it would be all right.” [R. 47.]

II.

Argument.

Appellee will confine its argument to that part of the Court's opinion which states:

“Even if the appellant did know the ultimate destination of the diamonds, there is not a word from which the jury could properly infer that he knew they were to be exported without a license. The only expression in the evidence upon the subject was from Takahashi who suggested that appellant help him procure a license, and this, of course, is far from evidence that it was the intent that no license should be obtained. The evidence creates no more than a suspicion.”

It is urged that the jury had competent and substantial evidence before it that fairly tended to prove the facts charged. It undoubtedly determined that the appellant, Goodman, had knowledge that the industrial diamonds purchased through him were to be sent to Japan; that it believed Takahashi's testimony with reference to requesting appellant to obtain a license to export the diamonds; that it considered appellant's statement to the Federal Bureau of Investigation Agents admitting his knowledge that it was illegal to export the diamonds without a license and the appellant's denial of the fact that he knew the diamonds were to be exported; that it considered the testimony of appellant in which he denied that Takahashi told him that he did not have a license and denied

that Takahashi had asked appellant to obtain a license to export diamonds to Japan.

In the case of *Ghadiali v. United States*, 17 F. (2d) 236, 237 (C. C. A. 9th), the Court said:

“The jury had before it all of the witnesses, could observe their demeanor, the reasonableness of the story, the opportunity of the witnesses for knowing the things about which they testified, the interest or lack of interest in the result of the trial, and all other disclosed circumstances bearing upon the credibility of the witnesses, and could determine where the truth in the case lay, and, if there is any evidence upon which rational minds might arrive at a like conclusion, this Court cannot reverse the finding.”

In the case of *Rendleman v. United States*, 38 F. (2d) 779, 780 (C. C. A. 9th), the Court said:

“Neither trial nor appellate court can invade province of jury touching credibility of witnesses and inferences to be drawn from testimony, where different inferences may reasonably be drawn.”

In the case of *Terry v. United States*, 51 F. (2d) 49, p. 53 (C. C. A. 4th), the Court said:

“The jury saw and heard the witnesses, including appellant, and observed their demeanor while they were testifying. In such cases the court may not invade the province of the jury and substitute its judgment for that of the jury on the weight and credibility to be accorded to the testimony of witnesses.”

Wherefore, appellee respectfully submits that its petition for rehearing should be granted.

Respectfully,

WM. FLEET PALMER,
United States Attorney,

LEO V. SILVERSTEIN,
Assistant U. S. Attorney,
Attorneys for Appellee.

Certificate of Counsel.

I, Leo V. Silverstein, one of the attorneys for appellee and petitioner in the above entitled cause, hereby certify that the foregoing petition for a rehearing is, in my judgment, meritorious and that said petition is presented in good faith and not for purposes of delay.

LEO V. SILVERSTEIN,
Counsel for Appellee.

United States 10
Circuit Court of Appeals
For the Ninth Circuit.

THE CITY OF FORSYTH, a municipal corporation of The State of Montana and FAIRBANKS, MORSE & COMPANY, a corporation,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY, a corporation,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United
States for the District of Montana
Billings Division

FILED

JAN 10 1942

PAUL P. O'BRIEN,

United States
Circuit Court of Appeals

For the Ninth Circuit.

THE CITY OF FORSYTH, a municipal corporation of The State of Montana and FAIRBANKS, MORSE & COMPANY, a corporation,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY, a corporation,

Appellee.

Transcript of Record

Upon Appeal from the District Court of the United
States for the District of Montana
Billings Division

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

	Page
Affidavit and Demand for Bill of Particulars.....	36
Answer of City of Forsyth.....	22
Answer of Fairbanks, Morse & Co.....	29
Appeal:	
Designation of Appellant of Contents of Record on	78
Designation of Appellee of Contents of Record on	81
Notice of	71
Statement of Points on.....	75
Attorneys, Names and Addresses of.....	1
Bill of Particulars.....	39
Caption	1
Clerk's Certificate to Transcript on Appeal.....	72
Complaint	2
Decision of the Court.....	63
Demand for Bill of Particulars.....	36
Designation of Appellant of Contents of Rec- ord on Appeal.....	78
Designation of Appellee of Contents of Rec- ord on Appeal.....	81

	Page
Judgment	69
Motion for Judgment on the Pleadings.....	62
Notice of Appeal.....	71
Order for Bill of Particulars.....	38
Order Pursuant to Stipulation.....	61
Statement of Points on Appeal.....	75
Stipulation Regarding Removal of Poles, etc.....	60

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For Appellees and Plaintiff. [1*]

In the District Court of the United States in and for
the District of Montana.

Billings Division
No. 183.

Mountain States Power Company,

Plaintiff,

vs.

City of Forsyth, and Fairbanks, Morse & Co.,
Defendants.

Be it remembered, that on May 27, 1940, a Complaint was duly filed herein, which is in the words and figures following, towit: [2]

*Page numbering appearing at foot of page of original certified Transcript of Record.

In the District Court of the United States
for the District of Montana

Billings Division

MOUNTAIN STATES POWER COMPANY,
Plaintiff,

vs.

CITY OF FORSYTH and FAIRBANKS, MORSE
& CO.,

Defendants.

COMPLAINT

Plaintiff complains of the defendants and alleges:

I.

Plaintiff is a corporation, incorporated under the laws of the State of Delaware.

The City of Forsyth, is a municipal corporation, organized and existing under and by virtue of the laws of the State of Montana.

The defendant Fairbanks, Morse & Co. is a corporation, incorporated under the laws of the State of Illinois; has qualified to do business as a foreign corporation in the State of Montana and, in doing so, had filed in the office of the Secretary of State of Montana a certificate certifying that it has consented to be sued in the courts of Montana upon all causes of action arising against it in this state, and that service of process may be made upon a person named in said certificate, a citizen of the State of

Montana and whose place of residence is stated and designated in said certificate, and further certifying that such service when so made upon such agent shall be valid service on said defendant.

The matter in controversy exceeds, exclusive of interest and costs, the sum of Three Thousand Dollars (\$3000.00).

II.

Plaintiff is and has been for several years the owner of an electric light and power plant or system in the City of Forsyth, State of Montana, [3] consisting of part of poles and wires in the streets and alleys of said city, and engaged in furnishing electric light and power to said city and the people of said city at rates prescribed by the Public Service Commission of Montana, which said electric light and power plant or system was constructed by the predecessor in interest and ownership of this plaintiff.

III.

The defendant City of Forsyth caused to be published in the Forsyth Independent, a newspaper published in said City, on the 18th day of April, 1940, a notice, a copy of which is hereto attached, marked Exhibit "A", and made a part hereof. In and by the specifications referred to in said notice and on file with the City Clerk, it was provided that:

"The agreement which the bidders agree to enter into will be in the form attached to these specifications. The agreement, specifications,

the drawings and the bid and acceptance constitute the contract documents.”

A copy of the form of agreement is attached hereto, marked Exhibit “B”, and made a part hereof.

IV.

In and by said specifications it is provided as follows:

“Conditional Acceptance of Bids

All bids will be received and any bid accepted will be accepted subject to the result of an election which will be called by the City Council and held as soon as practical after the acceptance of the bid, but no bid shall be final or binding on the City unless and until approved by the resident taxpayers at an election called at which said proposed contract will be submitted.

At this election there will be submitted to the resident taxpayers of the City to be by them voted upon at said election the question of approving or disapproving said proposed letting.

If the result of said election be that the resident taxpayers approve said letting at said election, then and in that event, a formal contract will be entered into with the successful bidder; but if the result of said election should be that the resident taxpayers did not approve said letting, then, and in that event, the acceptance of the bid of the successful bidder shall be

ipso facto null and void, shall be of no binding force and effect on either party, and neither party shall be liable for damages thereunder. If the validity of the said contract should be questioned by a suit in court and upon final court determination said contract shall be held illegal and void, then neither party shall be liable for damages thereunder.” [4]

“Completion

The contractor will not be required to begin work until ten days after litigation for the ousting of the power company now serving the city from its streets has been finally determined in favor of the city. The work shall be completed within 180 days after commencement.”

“Removal of Competition

The City undertakes to promptly institute such legal action or proceeding it may deem proper or advisable to have it declared by a judgment of a court of competent jurisdiction that the public Service Corporation now serving the City and its inhabitants has no right to use or occupy the streets, alleys or public grounds of the City with its poles, wires, or other instrumentalities, and that it be required to remove all of its equipment therefrom when the proposed plant of the City is ready for

production and distribution of electricity so that the City shall be free of its competition.”

“Title to Plant.

The title to the entire plant, including the said site and distribution system shall remain in the Contractor until the entire purchase price is paid with interest. When such price is paid, the Contractor shall convey the site hereinafore described together with the power house constructed thereon, and all appurtenances thereto to the Owner, and will convey to the Owner the same title which the Contractor has acquired from the Owner, the said conveyance to be made free from any encumbrances, subsequent to the Owner’s conveyance, and the City shall become the owner of the remainder of the entire plant by operation of law. If any further conveyance is requested by the Owner, it shall be made by the Contractor.

The entire plant, including distribution system and power house building howsoever parts thereof shall be installed or attached to the realty shall at all times until fully paid for, be and remain the personal property of the Contractor, and is to be conveyed in its entirety to the Owner when the entire contract price has been paid.”

“Method of Payment.

Payment of the contract let under these specifications shall be made solely out of the net

earnings of the light and power plant to be established hereunder. The net earnings are those which remain after deducting the cost of maintaining and operating the plant, including distribution system and power house. Such costs are the costs of labor, insurance, taxes, if any, fuel oil, lubricating oil, repairs, supplies, replacing parts, and all other necessary and legitimate expenses of maintaining and operating the said plant. The said net earnings shall be pledged to an extent sufficient to make the payments on the contract let under these specifications, with interest, as the same become due. Any earnings in excess of the amount required to make the payments of principal and interest on the contract as they shall become due shall be used only for the following purposes, at the discretion of the owner, namely:

(a) To pay for extensions and additions to the plant equipment and distribution system, and such additions and extensions shall be used in the operation of the plant equipment and distribution system, and the earnings therefrom shall be paid into the Light and Power Plant Fund herein provided for.

(b) To anticipate payments of principal and interest on the contract. [5]

It is to be expressly understood that the City does not guarantee to pay the contract price absolutely and at all events, and the said price shall in no event be or become a general obli-

gation of the city, or create any indebtedness against it, or be payable out of taxes or out of its general revenues, but payment therefor will be made solely out of the net earnings of the plant, and not otherwise.

The bidder shall specify in his bid the total amount thereof, the rate of interest on the deferred payments which shall not exceed five per cent per annum.

The contract let under these specifications shall be paid out of the net earnings of the Municipal Light, Heat and Power Plant as herein provided in monthly installments as follows: \$1250.00 Dollars on the first day of the sixth month after commencement of operation of the plant, and a like sum on the first day of each and every month thereafter until one-half of the contract price is paid, and \$1500.00 Dollars on the first day of each and every month thereafter until said contract price is paid in full. The unpaid balance of the contract price shall bear interest from the date of commencement of operation of the generating equipment, at the rate specified by the successful bidder in his bid, not exceeding, however, five per cent per annum, payable semi-annually out of the net earnings of said plant.”

“Default—Notice

No default shall exist or be declared under the contract to be entered into hereunder, nor shall the contractor be entitled to take posses-

sion of the plant or any part thereof unless and until there has been a default at one and the same time in six of the monthly installments of payment required to be made by the owner under the contract to be let hereunder, or unless and until a default in two semi-annual installments of interest, and in any event not until the contractor has given six months written notice, duly served upon the owner, of his intention to declare a default to exist, and no cancellation of the contract entitling the contractor to take possession shall be declared prior to the expiration of the time specified in the notice of contractor's intention to declare a default as above provided."

"Revenue Certificates

All deferred payments will be evidenced by certificates executed by and in the name of the City, representing payments to be made under the contract. Said certificates, however, are not to be considered as an additional, separate or independent obligation, apart from the contract, but merely a convenient way of evidencing the payments to be made under the contract, and the times of such payments."

"Rates

It is to be expressly understood that in no event shall the schedule of residential, commercial, power, lighting, heating, cooking, street

lighting, pumping or any other rates be increased over and above the following rates during the life of the contract.

Residential

First	10 KWH	for \$1.00	(Min)
Next	20 KWH	for	7¢
Next	55 KWH	@	4¢
Excess	KWH	@	3¢
Minimum		\$1.00	[6]

Commercial

First	10 KWH	for \$1.00	(Min)
Next	90 KWH	at	7¢
Next	200 KWH	at	6¢
Next	200 KWH	at	5¢
Next	500 KWH	at	4¢
Excess	KWH	at	3.5¢
Minimum		\$1.00	

Heat

First	20 KWH	for \$1.00	
Next	180 KWH	at	3.5¢
Excess	KWH	at	3¢
Minimum		\$1.00	

Power

First	200 KWH	at	6¢
Next	200 KWH	at	5.5¢
Next	200 KWH	at	5¢
Next	200 KWH	at	4.5¢
Next	2200 KWH	at	3¢
Excess	KWH	at	2¢
Minimum		\$1.00	per HP

Customers monthly bill will be computed at the net rate, and there will be added to the total net bill a sum equal to 10% thereof, which will be collected from customers who fail to pay the net bill within ten days after date of bill.

Street Lighting:

Burning dusk to dawn per month—\$190.00

Water Heating: .

Off peak water heating 1¢ per KWH Min.

Bill—\$1.00

Pumping:

All at \$.03

This rate shall apply to the City Water Plant and to the Sewage Disposal Plant. At the option of the City Water Department, they may elect to use the Power rate above."

"Labor

All skilled and common labor for this project shall be secured in the City of Forsyth so long as competent supply is available."

"Contractor Not Required to Commence Performance While Litigation Is Pending.

If any litigation should be instituted questioning the validity of the contract to be let hereunder; or questioning the authority of the Owner to make such contract, or questioning in any way the validity of the proceedings of the Owner, or its Council, relative to the establishment of a power plant, or relative to the letting

of this contract, the Contractor shall not be required to proceed with the performance thereof until such litigation is finally determined in favor of Owner." [7]

"General:

The proposed system shall be built on the streets and alleys of the City of Forsyth, Montana, across railroad rights of way, and on private property. The City of Forsyth will furnish all rights of way and obtain permission for the contractor to carry out his work on private property."

V.

Pursuant to said notice to bidders made a part hereof as Exhibit "A", the defendant Fairbanks, Morse & Co. presented and filed a bid in the sum of \$169,969.00, payable in monthly installments as provided in said specifications, with interest on deferred installments at the rate of 5% per annum, and thereafter, and on the 30th day of April, 1940, the City Council of said City accepted said bid, subject to the approval of the taxpaying electors of said City.

VI.

At an election held in the said City of Forsyth on the 25th day of May, 1940, there was submitted to the registered tax-paying electors the following question, to-wit:


"Shall the proposed contract between the City of Forsyth, Montana, and Fairbanks, Morse & Co., for furnishing and constructing

a complete municipal electric light, heat and power plant in and for said city, for the sum of \$169,969.00 payable in monthly installments, with interest at the rate of five per cent, per annum, solely out of the net earnings of such plant, in accordance with the plans and specifications and bid of said Fairbanks, Morse & Co., all of which are on file in the office of the city clerk, be approved?"

At said election a majority of the voters voted for the approval of said proposed contract.

VII.

The City is without power of authority to make or enter into said proposed contract and if said contract is entered into and said plant or system is constructed, as provided in said contract, the said City will become a competitor of plaintiff and take from plaintiff many of its customers and patrons, to its great and irreparable damage and injury.



VIII.

The City, in making and entering into said contract, is assuming to exercise power and authority conferred by Chapter 115 of the Laws [8] of Montana of 1937, as amended by Chapter 111 of the laws of Montana of 1939. The emergency mentioned in chapter 115, as amended, has ceased to exist and there is not now and has not been since long prior to the month of April, 1940, such a condition or situation as is described and recited there-

in as the reason or ground for the enactment of same, and said chapter, as amended, is not now and has not been since long prior to the month of April, 1940, of any force or effect. That if said emergency now exists, said chapter 115, as amended, does not confer any power or authority on the defendant City to make or enter into said proposed contract.

IX.

Chapter 115, as amended, is unconstitutional and void in that by Section 4 thereof, whether or not the emergency mentioned has ended is to be determined by the opinion of the Governor, whereas said question is a judicial question for determination by the Courts.

X.

Plaintiff has a franchise, by virtue of section 6645 of the Revised Codes of Montana of 1935, to occupy the streets, alleys and public grounds of said city with its poles and wires and the right to furnish electric light and power to said city and the inhabitants thereof, as it is now doing, and the action of said City in advertising for bids, holding said election and proposing to enter into said contract casts a cloud upon the title of this plaintiff to said franchise and right to furnish electric light and power, as aforesaid.

XI.

Said contract is void for want of mutuality in that in and by said contract it is optional with the

defendant, Fairbanks, Morse & Co. to proceed or not to proceed with the construction of said electric plant or system.

XII.

The provision of said contract with reference to rates is void and unenforceable in that the rates to be charged for light, heat and power furnished by or through such a plant or system must be fixed and prescribed by the Public Service Commission of Montana, which was well known to both of said defendants. That by agreeing that the rates should never be in excess of those provided in said contract the said defendants perpetrated a fraud upon the elec- [9] tors who voted at said election, and, if said electors had been informed that said rates may be increased at any time, many of said voters who approved of said contract at said election would have voted against said approval, the number of which are unknown to plaintiff, but plaintiff alleges that, except for said fraud, said proposed contract would not have been approved at said election.

XIII.

The plans and specifications for said plant or system were prepared by or under the direction or supervision of the defendant, Fairbanks, Morse & Co. and were so prepared as to prevent any competition in the bidding for the construction of said plant or system, in consequence of which the only bid presented was the bid of the said defendant Fairbanks, Morse & Co., as was intended by said defendant and the said City.

XIV.

That the plaintiff is and has been for several years a large taxpayer upon both real and personal property in said city.

XV.

That the plaintiff has no plain, speedy or adequate remedy in the ordinary course of the law.

Wherefore, plaintiff prays judgment:

1. That the plaintiff be granted a preliminary injunction enjoining the defendant City from removing the poles and wires of this plaintiff from the streets and alleys of said City or from in any manner interfering with the plant or system of this plaintiff, or the operation of same, and that the said defendants be enjoined from entering into said proposed contract, or, if said contract has been entered into, that said Fairbanks, Morse & Co. be enjoined from constructing such plant or system in accordance with said plans or specifications, or otherwise, and, upon final hearing, said injunction be made permanent.

2. For such other and general relief as plaintiff may be entitled to.

TOOMEY, McFARLAND & CHAPMAN,
GUNN, RASCH, HALL & GUNN,

By M. S. GUNN [10]

A member of said Firm

Residence and Postoffice Address;

Helena, Montana.

Attorneys for Plaintiff [11]

EXHIBIT "A"

NOTICE TO BIDDERS

Notice is hereby given that the City Council of the City of Forsyth, Montana, will, at a meeting to be held on the 25th day of April, 1940, at the hour of two o'clock p. m., receive and publicly open and consider bids for the furnishing and providing of all materials and labor, skill, machinery, tools and equipment of every kind and nature necessary to construct, and to construct, a complete light, heat and power plant for operation in and for said City, including generating machinery, equipment and auxiliaries, distribution system, power house, meters, house connections and site for the power house building, more particularly described in the specifications, all in accordance with the plans and specifications therefor on file with the City Clerk.

Plans may be examined in the office of the City Engineer, or may be had for a deposit of \$10, which deposit will be refunded to bidders upon the return of the plans and specifications in good condition.

Bidders are required to submit a lump sum bid for the entire plant as above specified and bids on individual parts or portions thereof will not be considered.

The successful bidder will be required to purchase the site as provided for in the specifications, at the price therein stated.

All bids must be under seal, must be directed to City Council of the City of Forsyth, must be accompanied with a certified check for five per cent, of

the amount of the bid, payable to the City, and must be deposited with the City Clerk not later than two o'clock P. M. on the 25th day of April, 1940. The said check will be forfeited to the City as liquidated damages in case the bidder whose bid has been accepted fails or refuses to enter into the proposed contract and give the bond for the performance of said contract required by Section 5668.41 of the revised codes of Montana, 1935, and all laws amendatory and supplemental thereto and conditioned as required by the specifications.

Payment of the Contract will be made solely out of the net earnings of the plant. Each bidder is required to include the price of the site and the rate of interest which he is willing to accept on the deferred payments not exceeding five per cent. per annum.

All bids will be received and any bid will be accepted subject to the approval of the resident tax payers of the City at an election at which the proposed contract will be submitted. If the acceptance of the bid and the proposed contract be approved by the resident tax payers, then a formal contract will be executed with the successful bidder. If the acceptance of the bids be disapproved, then the acceptance will be null and void.

The City reserves the right to reject any and all bids.

By order of the City Council,

By H. V. BEEMAN,
City Clerk. [12]

EXHIBIT "B"
FORM OF CONTRACT

The following shall be substantially the form of contract to be entered into between the City and the successful bidder:

This Agreement, Made and entered into this day of, 19....., by and between the City of Forsyth, Montana, as party of the first part, hereinafter called the City, and as party of the second part, hereinafter called the Contractor, Witnesseth:

(1) That the Contractor, in consideration of the covenants and agreements of the City hereinafter contained to be kept and performed by it, hereby agrees to:

Furnish and provide all material, labor, skill, machinery, tools and equipment of every kind and nature necessary to construct, and to construct, a complete light, heat and power plant ready for operation in and for the city including generating machinery and equipment, distribution system, power house, meters, house connections from distribution system, and the site for the power building described in the specifications, all in accordance with the plans and specifications, the bid or proposal of the Contractor, and its acceptance by the Council for the sum of Dollars, which plans, specifications, bid and acceptance thereof are hereby attached, marked Exhibits "A" to "D"

inclusive, respectively, and hereby made a part hereof.

(2) The Contractor agrees to purchase the site provided for in the specifications at the price therein stated, and to construct the power house thereon.

(3) The Contractor agrees to accept payment for the plant out of the net earnings thereof exclusively, as provided in the specifications; and agrees to start and complete the said plant within the time limited in said specifications, except that in case of litigation the contractor shall not be required to commence performance until such litigation is finally determined. The Contractor further agrees to accept payment for the plant in the instalments and at the times stated in these specifications with interest at the rate stated in said bid, payable semi-annually.

(4) In accordance with specifications the Contractor reserves title to the entire plant until it is fully paid for, with interest, and upon such payment being made will convey same to the City. The City when plant is completed, and accepted shall be entitled to take immediate possession thereof, and to operate same.

(5) The City hereby hires and employs the said Contractor to supply all material, labor, skill, tools, machinery, equipment, instrumentalities and work of every kind and nature, provided for or specified in paragraph One (1) hereof, necessary to construct and to construct, a complete light, heat and power plant ready for operation in and for said City, in-

cluding generating machinery and equipment, distribution system, power house, meters, house connections and distribution system, and site for power house, all in accordance with the plans and specifications therefor, and upon the site designated in the specifications, for the sum of Dollars, to be paid out of the net earnings of the plant as provided in the specifications, and not otherwise.

In Witness Whereof, The parties hereto have hereunto caused their corporate names to be subscribed by their duly authorized officers or [13] agents, each the day and year first above written.

CITY OF FORSYTH,

By

Mayor

And

City Clerk

By

Its Duly Authorized Agent

[Endorsed]: Filed May 27, 1940. [14]

Thereafter, on August 9, 1940, an Answer of Defendant City of Forsyth, was duly filed herein, being in the words and figures following, towit: [23]

[Title of District Court and Cause.]

ANSWER OF DEFENDANT CITY OF FOR-
SYTH, A MUNICIPAL CORPORATION.

Now comes the City of Forsyth, a municipal corporation, one of the defendants in the above entitled action and for its answer to the Complaint of the plaintiff in said action, admits:

(1) That the City of Forsyth is a municipal corporation, organized and existing under the laws of the State of Montana;

(2) That plaintiff is and has been for several years the owner of an electric light and power plant in the City of Forsyth, Montana, consisting in part of poles and wires in the streets and alleys of said city, and has been for several years engaged in furnishing electric light and power to said city and its inhabitants.

(3) That the defendant, city of Forsyth, caused to be published in the Forsyth Independent, a newspaper published in said city, on the 18th day of April, 1940, a Notice, of which Exhibit A attached to the complaint is a correct copy; that in and by the specifications referred to in said Notice and on file with the city clerk, the provision quoted in paragraph III of the complaint was set out; that Exhibit B attached to the complaint is a copy of the form of agreement referred to in paragraph III.

(4) That the provisions quoted in paragraph IV of the complaint were and are contained in the specifications referred to.

(5) That the defendant Fairbanks, Morse & Company, presented and filed with the defendant city, a bid in the sum of One Hundred Sixty-nine Thousand, Nine Hundred Sixty-nine (\$169,969.00) Dollars, payable in monthly installments, as provided for in the specifications, with interest on deferred [24] installments at the rate of five per cent per annum, and admits that on the 30th day of April, 1940, the City Council of the defendant city accepted said bid, subject to the approval of the taxpaying electors of said city.

(6) That at an election held in said city on the 25th day of May, 1940, there was submitted to the registered taxpaying electors of said city, the question quoted in paragraph VI of the complaint, and that at said election a majority of the taxpaying electors voted for the approval of said proposed contract.

(7) Except as hereinabove expressly admitted, this defendant denies each and every allegation of the said complaint.

(8) Further answering, this defendant alleges that the said city of Forsyth in making and entering into the said contract is proceeding under authority conferred upon it by the decisions of the Supreme Court and statutes of the State of Montana, including the statutes referred to in paragraph VIII of the complaint, and claims and alleges that under said laws and statutes it has full power and authority to enter into said contract, and to establish a municipal light, heat and power plant in and for said city.

(9) Further answering, this defendant alleges that heretofore, to-wit, on or about the tenth day of September, 1904, one, John E. Edwards, made application to the town Council of the town of Forsyth, Montana, for a franchise to construct and maintain an electric light plant in the town of Forsyth, for the purpose of supplying said town and the people thereof with electric light for public and private use; that thereafter, and on or about the 15th day of October, 1904, Ordinance numbered 32, entitled "An Ordinance to Grant to John E. Edwards, his heirs, executors, administrators and assigns the privilege of Constructing, Maintaining and Operating an electric light plant in the town of Forsyth, State of Montana, and to permit them to use the streets and alleys of said town in connection therewith," was duly passed by the said town Council; that in and by said Ordinance it was provided that a franchise was granted to the said John E. Edwards for the purpose aforesaid, for a period of twenty years from and after the time the said ordinance took effect; that thereafter, the said ordinance was duly submitted to the resident freeholders and taxpayers of said town, for rejection or approval, at an election which was duly called and held on the 30th day of September, 1904, and [25] that at said election the said ordinance was approved; that the defendant, city of Forsyth, is the successor of the said town of Forsyth; that the plaintiff herein is the assignee of the said John E. Edwards, or of an assignee or assignees of the said

John E. Edwards, and derives its right to occupy the streets and alleys of the said city of Forsyth from the said ordinance No. 32, and not otherwise; that the right to occupy said streets and alleys under said ordinance has long since expired, and that the plaintiff herein is and at the time of the commencement of this action was occupying said streets and alleys of said city solely during the will and pleasure of the said defendant, city of Forsyth; that a true and correct copy of said ordinance No. 32 is hereto attached, marked Exhibit A, and hereby made a part hereof.

(10) Further answering, this defendant alleges that heretofore, to-wit, on the 26th day of September, 1905, the said John E. Edwards, the grantee under said ordinance No. 32, duly organized a corporation under the name of the Forsyth Electric Light & Power Company for the purpose of generating and furnishing electric light and power for public and private use in the said town of Forsyth, Montana; that the term for which said corporation was organized to exist was twenty years from and after the date of incorporation, which was the 26th day of September, 1905; that thereafter, and on or about the third day of January, 1921, the said Forsyth Electric Light & Power Company changed its name to the Forsyth Light & Power Company; that the said corporation was and is the assignor and the plaintiff herein, and the corporation from which it acquired the rights that it claims to have in the

streets and alleys of the city of Forsyth; that at the time of the attempted transfer of the said franchise to the plaintiff, herein, the assignor thereof had no rights to transfer, and the plaintiff herein acquired no rights by virtue of any transfer or assignment from the said John E. Edwards, or any of his assignees.

Wherefore, This defendant prays that the plaintiff be denied any relief herein, and that the said action be dismissed, with costs against the said plaintiff.

F. F. HAYNES

Attorney for the Defendant,
City of Forsyth,
Post Office Address,
Box 676, Forsyth, Montana.

[Endorsed]: Filed Aug. 9, 1940. C. R. Garlow,
Clerk. [26]

EXHIBIT A

Ordinance No. 32

An ordinance to Grant to John E. Edwards, his heirs, executors, administrators and assigns, privilege of constructing, maintaining and operating an electric light plant in the Town of Forsyth, State of Montana, and to permit them to use the streets and alleys of said Town in connection therewith.

Be it Ordained by the Town Council of the Town of Forsyth.

Section I: That there is hereby granted to John E. Edwards, his heirs, executors, administrators, or assigns, the privilege and right of maintaining, constructing and operating an electric light plant in the Town of Forsyth, State of Montana, for the purpose of supplying said Town and the people thereof with electric lights, for public and private uses, for hire, tolls, and otherwise.

Section II: The privilege and right of using the streets and alleys of the Town of Forsyth, State of Montana, as they now are, or as they may be hereafter established, for the purpose of erecting and maintaining electric light poles and stringing electric light wires, on said poles, which said privilege shall continue for a period of twenty years, from and after the time this Ordinance takes effect.

Section III: The privilege and right of making excavations in the streets and alleys of the said Town of Forsyth, State of Montana, as they now are, or as they may be hereafter established, for the purpose of erecting and maintaining electric light poles therein.

Section IV: That after the passage, approval and publication of this Ordinance, the said John E. Edwards shall file a written acceptance thereof, for himself, his heirs, executors, administrators, and assigns, with the Town Clerk of the said Town of Forsyth.

Section V: That this Ordinance shall take effect and be in full force upon its passage, approval and publication, and acceptance.

Approved this 15th day of October, 1904.

CHAS. B. TABER

Mayor

Attest:

C. W. BAILEY

Clerk

Corporation Seal [27]

EXHIBIT VERIFICATION

State of Montana,

County of Rosebud—ss.

C. H. Burley, being first duly sworn on oath, deposes and says: That he is the duly elected Mayor of Forsyth, Montana, one of the Defendants named in the foregoing answer; that he has read the foregoing answer and the matters and things therein contained are true to his own knowledge; that he is duly authorized by the City Council of the City of Forsyth, Montana, by proper proceedings in his official capacity to execute this verification.

C. H. BURLEY

Subscribed and sworn to before me this 8th day of August, 1940.

F. F. HAYNES

Notary Public for the State of Montana, Residing at Forsyth, Montana.

My commission expires June 16, 1942.

Filed Aug. 9, 1940. C. R. Garlow, Clerk. [28]

Thereafter, on August 16, 1940, an Answer of Defendant Fairbanks, Morse & Company, was duly filed herein, in the words and figures following, to-wit: [29]

[Title of District Court and Cause.]

ANSWER OF DEFENDANT FAIRBANKS,
MORSE & COMPANY.

Now comes Fairbanks, Morse & Company, one of the defendants in the above entitled action, and for its answer to the Complaint of the plaintiff in said action, admits:

(1) That plaintiff is a corporation organized under the laws of the State of Delaware; that the city of Forsyth is a municipal corporation, organized and existing under the laws of the State of Montana; that the defendant, Fairbanks, Morse & Company, is a corporation organized under the laws of the State of Illinois; that it has qualified to do business as a foreign corporation in the State of Montana, and has complied with the laws of the State of Montana with respect to foreign corporations doing business in the state.

(2) That plaintiff is and has been for several years the owner of an electric light and power plant in the city of Forsyth, Montana, consisting in part of poles and wires in the streets and alleys of said city, and has been for several years engaged in furnishing electric light and power to said city and its inhabitants.

(3) That the defendant, city of Forsyth, caused to be published in the Forsyth Independent, a newspaper published in said city, on the 18th day of April, 1940, a Notice, of which Exhibit A attached to the complaint is a correct copy; that in and by the specifications referred to in said Notice and on file with the city clerk, the provision quoted in paragraph III of the complaint was set out; that Exhibit B attached to the complaint is a copy of the form of agreement referred to in paragraph III. [30]

(4) That the provisions quoted in paragraph IV of the complaint were and are contained in the specifications referred to.

(5) That the defendant, Fairbanks, Morse & Company, presented and filed with the defendant city, a bid in the sum of One Hundred Sixty-nine Thousand, Nine Hundred Sixty-nine (\$169,969.00) Dollars, payable in monthly installments, as provided for in the specifications, with interest on deferred installments at the rate of five per cent. per annum, and admits that on the 30th day of April, 1940, the City Council of the defendant city accepted said bid, subject to the approval of the tax-paying electors of said city.

(6) That at an election held in said city on the 25th day of May, 1940, there was submitted to the registered taxpaying electors of said city, the question quoted in paragraph VI of the complaint, and that at said election a majority of the taxpaying electors voted for the approval of said proposed contract.

(7) Except as hereinabove expressly admitted, this defendant denies each and every allegation of the said complaint.

(8) Further answering, this defendant alleges that the said city of Forsyth in making and entering into the said contract is proceeding under authority conferred upon it by the decisions of the Supreme Court and statutes of the state of Montana, including the statutes referred to in paragraph VIII of the complaint, and claims and alleges that under said laws and statutes it has full power and authority to enter into said contract, and to establish a municipal light, heat and power plant in and for said city.

(9) Further answering, this defendant alleges that heretofore, to-wit, on or about the tenth day of September, 1904, one John E. Edwards, made application to the town Council of the town of Forsyth, Montana, for a franchise to construct and maintain an electric light plant in the town of Forsyth, for the purpose of supplying said town and the people thereof with electric light for public and private use; that thereafter, and on or about the 15th day of October, 1904, Ordinance numbered 32, entitled "An Ordinance to Grant to John E. Edwards, his heirs, executors, administrators and assigns the privilege of Constructing, Maintaining and Operating an electric light [31] plant in the town of Forsyth, State of Montana, and to permit them to use the streets and alleys of said town in connection therewith," was duly passed by the said town Council; that in and by said Ordinance it was

provided that a franchise was granted to the said John E. Edwards for the purpose aforesaid, for a period of twenty years from and after the time the said ordinance took effect; that thereafter, the said ordinance was duly submitted to the resident freeholders and taxpayers of said town, for rejection or approval, at an election which was duly called and held on the 30th day of September, 1904, and that at said election the said ordinance was approved; that the defendant, city of Forsyth, is the successor of the said town of Forsyth; that the plaintiff herein is the assignee of the said John E. Edwards, or of an assignee or assignees of the said John E. Edwards, and derives its right to occupy the streets and alleys of the said city of Forsyth from the said ordinance No. 32, and not otherwise; that the right to occupy said streets and alleys under said ordinance has long since expired, and that the plaintiff herein is and at the time of the commencement of this action was occupying said streets and alleys of said city solely during the will and pleasure of the said defendant, city of Forsyth; that a true and correct copy of said ordinance No. 32 is hereto attached, marked Exhibit A, and hereby made a part hereof.

(10) Further answering, this defendant alleges that heretofore, to-wit, on the 26th day of September, 1905, the said John E. Edwards, the grantee under said ordinance No. 32, duly organized a corporation under the name of the Forsyth Electric Light & Power Company for the purpose of generating and furnishing electric light and power for

public and private use in the said town of Forsyth, Montana; that the term for which said corporation was organized to exist was twenty years from and after the date of incorporation, which was the 26th day of September, 1905; that thereafter, and on or about the third day of January, 1921, the said Forsyth Electric Light & Power Company changed its name to the Forsyth Light & Power Company; that the said corporation was and is the assignor and the plaintiff herein, and the corporation from which it acquired the rights that it claims to have in the streets and alleys of the city of Forsyth; that at the time of the attempted transfer of the said franchise to the plaintiff, herein, the assignor thereof had no rights to transfer, and the plain- [32] tiff herein acquired no rights by virtue of any transfer or assignment from the said John E. Edwards, or any of his assignees.

Wherefore, this defendant prays that the plaintiff be denied any relief herein, and that the said action be dismissed, with costs against the said plaintiff.

KYLE & KYLE

By JOHN P. KYLE

A Member of said Firm,

Residence: St. Paul, Minne-
sota,

Post Office: 618 Guardian
Bldg., St. Paul, Minn.

Attorneys for Defendant,
Fairbanks, Morse & Co.

EXHIBIT A

Ordinance No. 32

An Ordinance to Grant to John E. Edwards, his heirs, executors, administrators and assigns, privilege of constructing, maintaining and operating an electric light plant in the Town of Forsyth, State of Montana, and to permit them to use the streets and alleys of said Town in connection therewith.

Be it Ordained by the Town Council of the Town of Forsyth.

Section I: That there is hereby granted to John E. Edwards, his heirs, executors, administrators, or assigns, the privilege and right of maintaining, constructing and operating an electric light plant in the Town of Forsyth, State of Montana, for the purpose of supplying said Town and the people thereof with electric lights, for public and private uses, for hire, tools, and otherwise.

Section II. The privilege and right of using the streets and alleys of the Town of Forsyth, State of Montana, as they now are, or as they may be hereafter established, for the purpose of erecting and maintaining electric light poles and stringing electric light wires, on said poles, which said privilege shall continue for a period of twenty years, from and after the time this Ordinance takes effect.

Section III: The privilege and right of making excavations in the streets and alleys of the said Town of Forsyth, State of Montana, as they now are, or as they may be hereafter established, for the

purpose of erecting and maintaining electric light poles therein.

Section IV: That after the passage, approval and publication of this Ordinance, the said John E. Edwards shall file a written acceptance thereof, for himself, his heirs, executors, administrators, and assigns, with the Town Clerk of the said Town of Forsyth.

Section V: That this Ordinance shall take effect and be in full force upon its passage, approval and publication, and acceptance.

Approved this 15th day of October, 1904.

CHAS. B. TABER

Mayor

Attest:

C. W. BAILEY

Clerk

Corporation Seal [34]

State of Minnesota,
County of Ramsey—ss.

Esther P. McEvoy, being first duly sworn, on oath deposes, and says:

That heretofore, to-wit, on the sixth day of August, 1940, at the city of St. Paul, Minnesota, she served the attached Answer of Fairbanks, Morse & Company upon Gunn, Rasch, Hall & Gunn, attorneys for the plaintiff therein named, by then and there depositing in the Post Office in the city of St.

Paul enclosed in a sealed envelope, with postage thereon prepaid, the attached answer, addressed to the said attorneys as follows:

“Gunn, Rasch, Hall & Gunn,
Attorneys at Law,
Helena, Montana.”

ESTHER P. McEVOY

Subscribed and sworn to before me this 12th day of August, 1940.

(Seal)

JOHN P. KYLE

Notary Public, Ramsey County, Minn.

My Commission expires April 9, 1944.

[Endorsed]: Filed Aug. 16, 1940. C. R. Garlow,
Clerk. [35]

Thereafter, on June 18, 1940,

AFFIDAVIT AND DEMAND FOR BILL OF PARTICULARS

was duly filed herein, being the words and figures following, towit: [36]

[Title of District Court and Cause.]

State of Minnesota,
County of Ramsey—ss.

John P. Kyle, being first duly sworn, on oath deposes, and says:

That he is a member of the law firm of Kyle & Kyle, who are attorneys for the defendant, Fairbanks, Morse & Co. in the above entitled action, and

who will represent them in the preparation for trial and in the trial of said action; that paragraph XIII of the complaint herein in the following words, to-wit:

“The plans and specifications for said plant or system were prepared by or under the direction or supervision of the defendant, Fairbanks, Morse & Co. and were so prepared as to prevent any competition in the bidding for the construction of said plant or system * * *,”

is so indefinite and uncertain as not to inform this defendant of the precise part or parts of the said specifications which it is intended to be claimed “were so prepared as to prevent competition in the bidding for the construction of said plant or system”; that the plans and specifications for said plant are of a voluminous character, the General Conditions thereof consisting of sixteen typewritten pages, besides elaborate descriptions of the mechanical and structural parts of the proposed plant; that neither affiant nor the firm to which affiant belongs, is able to properly prepare said case for trial or to meet the proofs that may be offered by the plaintiff upon said trial, unless the defendant or its attorneys be informed of the precise part or parts of the said specifications which the plaintiff intends to claim were so prepared as to prevent any competition [37] in the bidding for the construction of said plant or system.

Wherefore, Affiant prays that the said plaintiff

be required to specify and set out the particular part or parts of the said plans and specifications which the said plaintiff intends to claim were so prepared as to prevent any competition in the bidding for the construction of said plant.

JOHN P. KYLE

Subscribed and sworn to before me this 14th day of June, 1940.

(Notarial Seal) ESTHER P. McEVOY
Notary Public, Ramsey County, Minn.

My Commission expires May 20, 1941.

[Endorsed]: Filed June 18, 1940. C. R. Garlow,
Clerk. [38]

Thereafter, on July 22, 1940, Order for Bill of Particulars was duly filed and entered herein, being in the words and figures following, towit: [39]

[Title of District Court and Cause.]

ORDER

The defendants herein having moved the Court for an order requiring the plaintiff to make the allegations of paragraph XIII of the complaint more definite and certain by stating and setting out verbatim the particular part or parts of the plans and specifications for the electric plant or system described in the complaint, which were so prepared as to prevent competition in the bidding for the construction of said plant or system, and

plaintiff having confessed said motion, and the parties agreeing that plaintiff may have additional time, beyond the ten day period subsequent to notice fixed by Rule 12(e):

It is ordered: that plaintiff prepare, serve and file herein statement for Bill of Particulars in response to said motion on or before Monday the 29th day of July, 1940.

Done and dated this 22nd day of July, 1940, nunc pro tunc as of June 28, 1940.

CHARLES N. PRAY

United States District Judge

[Endorsed]: Filed and entered July 22, 1940.
C. R. Garlow, Clerk. [40]

Thereafter, on July 27, 1940,

BILL OF PARTICULARS

was duly filed herein by the Plaintiff, being in the words and figures following, towit: [41]

[Title of District Court and Cause.]

The plaintiff for its Bill of Particulars herein, demanded by the defendants, sets forth and alleges as follows:

That the plans and specifications were, as alleged in paragraph XIII of the complaint, prepared by or under the direction or supervision of the defendant, Fairbanks, Morse & Co., and were so pre-

pared as to prevent any competition in the bidding for the construction of said plant or system.

That said specifications were so prepared, with the consent and approval of the said defendant city and its officials, and with the understanding between said defendants that no one but the defendant Fairbanks, Morse & Co. would bid for the furnishing of said plant or system, in violation of Section 5070 of the Revised Codes of Montana of 1935, as amended by Chapter 18 of the Laws of Montana of 1939.

That the parts of said specifications which were so prepared as to prevent competition in the bidding for the construction of said plant or system are as follows, to-wit:

“Three Diesel Engines shall be furnished under these specifications with an approximate capacity of 300 HP, 375 HP and 450 HP each, or as near to these standard ratings as the manufacturer’s standard ratings will allow. In no event shall the total plant horsepower be less than 1100 HP. Each unit shall be capable of carrying its full load continuously without undue stresses and strains. Each unit shall also be capable of delivering a 10% overload for a period of not less than two hours on test. Each engine shall be of the full Diesel type, operating at approximately 500 lbs. compression pressure. The M. E. P. shall not exceed 80 lbs. for the four cycle type and 60 lbs. for the two cycle type. Only engines of solid injection or mechan-

ical injection type [42] will be acceptable. The rotative speed shall not exceed 360 RPM and the piston speed shall be not more than 1100 feet per minute. Engines of slow rotative speed and low piston speed are desired.

It is the intent of these specifications to require a stationary type of engine of heavy duty design which will operate continuously at full load. The engines shall be so designed as to be of neat and rigid construction, fully enclosed with hand hole plates provided for easy access to the moving parts. With certain exceptions as herein specified, the detail of the engine design is left to the engine manufacturer. Bidders are, therefore, requested to submit with their bid descriptive literature showing the general construction of the unit bid upon.

The crankshaft shall be made from a single billet of open hearth steel with the usual heat treating. The shaft shall be of heavy design to provide a large factor of safety against any abnormal strain, and must have been 'electric eye' tested for flaws before being installed.

The engines to be furnished under these specifications shall be equipped with cylinders and pistons designed in accordance with the general practice of the trade. Only trunk type pistons, however, will be considered, and the pistons shall be designed with a large piston pin and sufficient piston rings to insure long wear and minimum blow-by.

Cylinders with or without cylinder liners will be acceptable. When cylinder liners are not used, the cylinder wall shall be of sufficient thickness to allow for at least two reborings.

When cylinder liners are used, the design of the cylinder shall be such that the liner can be conveniently removed and a satisfactory seal must be made between the cylinder liner and the cylinder to avoid leakage of water into the crankcase. Where cylinder liners are bid upon, the bidder shall submit with his bid sufficient detailed information so that the owner can determine in his own mind whether the seal is satisfactory.

The connecting rods shall be forged from a single solid billet of open hearth steel carefully machined and guaranteed to be in perfect alignment. The connecting rods shall be of such a design that the crank pin bearing is not integral with the connecting rod bearing.

The engine shall be provided with a complete fuel injection system of the mechanical or solid injection type. Differential type of injection nozzle must be furnished operating at an injection pressure of from 2,000 to 3,000# per square inch. Each engine shall be equipped with one spare injection nozzle. The injection system shall be complete with a nozzle testing jig, with pressure gauge, so that the nozzles can be tested in the field. The injection nozzles must be water-cooled so that proper operation can be assured.

The flywheel to be furnished with the engine shall be of sufficient size and weight to insure smooth operation of the engine under varying loads.

The engine shall be furnished with a Woodward isochronous governor of the most modern design. The governor shall be furnished with remote control for mounting on the switchboard so that the speed of the engine can be changed from the switchboard when paralleling the engine.

The cooling system to be furnished under these specifications shall be a complete dual system which shall circulate soft water thru the jackets of the Diesel engine, which in turn will be cooled by a heat exchanger. The raw water system shall consist of passing the raw water thru the heat exchanger and cooling by the cooling tower. The system shall be furnished complete with the necessary pumps, heat exchanger, cooling tower, pipes, valves, fittings, gauges and surge tank, as hereinafter specified.

[43]

Three motor driven centrifugal circulating pumps shall be furnished, one to be used for raw water, one for soft water and one as a spare. The pumps shall be of the horizontally split case type with direct connected motor and mounted on a common sub-base, and shall have a capacity of not less than 300 GPM against a head sufficiently high to pass the required

amount of water (300 gpm) thru the respective cooling system. The successful contractor shall be required to determine the proper size of motor to be installed on the pumps so that they will deliver the rated capacity against the head to be created in the system without overloading the motor.

The contractor will be responsible for supplying pumping units which will supply ample cooling under maximum load conditions.

Each motor shall be furnished with an across-the-line starter with push button control. The motor shall be designed for 220 volts, 3 phase service and of the standard squirrel cage type.

Two heat exchangers shall be furnished under these specifications. They shall be of the shell and tube type as similar to the Schutte-Koerting or Griscolm-Russell or approved equal.

Each heat exchanger shall be of a capacity to handle the cooling water for a 500 HP. These ratings shall be based on the soft water entering the heat exchanger at a temperature of approximately 140 degrees F. and discharging from the heat exchanger at a temperature of not greater than 125 degrees F. with a circulation of 300 gpm and with raw water entering the heat exchanger at a temperature of not more than 103 degrees F. and discharging from the heat exchanger at a temperature of approximately 118 degrees F.

The Contractor shall furnish and install four heat units at the location shown on the drawing. The one in the office shall be Modine No. 73-W, the three in the power room shall be Modine 399-W, or approved equal. Each unit shall be equipped with a three way switch, and shall be properly piped and valved to the cooling system in such a manner and using pipe sizes that they will operate satisfactorily.

There shall be furnished under these specifications a surge tank having a capacity of not less than 200 gallons, which shall be built of not less than No. 10 gauge steel. This surge tank shall be properly located in the power house building and equipped with a gauge glass so that the water level in the tank can be conveniently observed. The surge tank shall be connected to the cooling system as shown in the drawings.

An atmospheric type cooling tower shall be furnished under these specifications. The tower shall have sufficient capacity to cool the equivalent of 750 HP under the conditions set out in the paragraphs covering cooling system, circulating pumps and heat exchanger.

The successful contractor will be required to furnish a cooling tower which will operate satisfactorily under these conditions and he shall be required to submit complete information to the engineers for approval before the cooling

tower is shipped. The cooling tower shall be of the type similar to that furnished by the Marley Company or approved equal.

The contractor shall furnish and install a water softender capable of delivering not less than 75 GPH of softened water, Red Jacket Model #S36B, or approved equal. The softener shall have sufficient softening capacity so that operating with the equipment bid upon and using city water, it will not have to be regenerated more than once during 24 hours while furnishing the necessary make-up water. Rinse water disposal shall be to the City water plant filter waste line.

Indicating and alarm gauges shall be furnished for the cooling system as covered by the specifications covering gauge panel.

The Diesel engines shall be designed for starting with compressed air using an air pressure of not more than 250# per square inch. [44]

The work to be done under these specifications shall include the furnishing and installation of the complete air starting equipment as required. The air starting equipment shall consist of one motor driven air compressor operating at a maximum pressure of 250# per square inch and with a capacity of not less than 20 cubic feet of free air per minute.

This compressor shall be V-belt driven by a three phase, 60 cycle, 220 volt motor. The motor

shall be furnished complete with across-the-line starter and remote control, which will start the compressor when the pressure is lower than 200# per square inch and will shut the compressor off when the pressure exceeds 250# per square inch. There shall also be furnished a separate air compressor of the same specifications as above except that this compressor shall be driven with a gasoline engine. The size of the motor and gasoline engine shall be such that they will not be overloaded when the compressor is operating under its maximum condition. This gasoline engine driven compressor shall be properly cross-connected to the motor driven compressor lines.

The contractor under these specifications shall also furnish and install three air tanks of a size approximately 20x60" and built in accordance with specifications of the ASME. The air tanks shall be equipped with necessary pressure gauges, pop safety valve, globe valves and fittings.

Each engine shall be furnished with a cast-iron water cooled exhaust manifold. The contractor shall furnish all necessary exhaust equipment connecting from the exhaust manifold on the engine to the atmosphere in accordance with the drawings. The exhaust system generally shall consist of connecting from the water cooled exhaust manifold running directly

down to a point under the flow and then horizontally to a concrete exhaust chamber, which shall be built in accordance with the drawings and specifications under 'Building'. From here the exhaust gases shall be carried thru an exhaust silencer thru the exhaust stack to atmosphere.

The pipe connection between the manifold and the concrete exhaust chamber shall be of a size as recommended by the engine manufacturer and shall be built of not less than 1/4" steel and where buried under floor, shall be class 100 cast iron. This line shall have the necessary expansion joint in it to satisfactorily take care of expansion and contraction.

The concrete exhaust chamber shall be complete with necessary manhole and stack thimble.

There shall be furnished for each engine and mounted on the concrete exhaust chamber an exhaust silencer as manufactured by the Maxim Silencer Company or Burgess Battery Company or approved equal and shall have sufficient silencing ability to assure that the exhaust noises cannot be heard farther than 100' from the power plant.

The exhaust stack shall be placed on top of the exhaust silencer and shall be of the diameter recommended by the engine manufacturer. This stack shall be made of not less than 1/4" thick steel and shall be of such a length so that the exhaust will be emitted to the atmosphere

not less than 5' above the top of the power plant building.

The contractor shall furnish a pyrometer and necessary thermocouples so that the exhaust temperature of each individual cylinder can be determined conveniently. The pyrometer shall have sufficient points so that there will be one point for each cylinder and shall be of the type as manufactured by Alnor or Brown, or approved equal. The pyrometer shall be mounted on the gauge panel as covered by the specifications covering "gauge panel".

The contractor shall furnish and install a complete air intake system for each engine as shown on the drawings. The air intake system shall include the air filter house as shown on the drawing air filter and interconnecting pipe.

The air filters shall be of the type as manufactured by the American Air Filter Company, Model 20Z01 and 24Z01, Cy coil, or approved equal. They shall be furnished complete with one spare cell for each engine and a washing and charging tank together with ten gallons of charging fluid. [45]

The contractor shall furnish and install a pipe of the proper size as recommended by the engine manufacturer connecting the engine to the air filter house. This pipe shall be made of not less than 1/4" thick steel and where buried under floor, shall be class 100 cast iron, and

shall be furnished with the necessary expansion joints.

The air filter house shall be furnished complete with air filter unit frames, louvers and manhole. The contractor shall guarantee that the air intake noise shall not be heard at a distance of more than 150' from the power plant, and if a silencer is required for this purpose, it shall be furnished by this contractor.

A lubricating oil system shall be furnished complete by this contractor including dirty oil storage tank, clean oil storage tank, lubricating oil purifier and such other equipment as is necessary for the type of engine bid upon.

The clean and dirty lubricating oil tanks shall have a capacity of not less than 200 gallons each and shall be made of not less than No/10 gauge steel. The tanks shall be furnished with a gauge glass so that the level of oil in each tank can be readily determined.

The tanks shall be mounted in an angle iron frame in the position shown on the drawing with the dirty oil tank located directly above the clean oil tank.

This contractor shall furnish and install a lubricating oil purifier similar to that manufactured by the Hilliard Corporation and shall have a capacity of not less than 10 gallons per batch. The purifier shall be equipped with the necessary electrical heating elements and shall

be furnished with complete supplies to last for not less than 30 days.

There shall be furnished under these specifications complete fuel oil system including the storage tank, day tanks, piping, transfer pumps and fuel oil meters.

The contractor shall furnish and install a 20,000 gallon fuel oil storage tank. The tank shall be arranged for vertical installation and shall have approximate dimensions of 11' x 30'. It shall be made of not less than 1/4" bottom, 3/16" shell and No. 12 gauge cover. The tank shall be installed on a footing as shown on the drawing and shall be located as directed by the engineer.

Bearing surfaces of concrete, wherever in contact with the steel shall be coated with at least 1/4" of bituminous compound, Inertol Hot-mastic, or approved equal.

The day tanks, which it is contemplated to bury underground, must be given at least three coats of Inertol Standard Black or approved equal, and care used to install the tanks without injuring the coating.

The contractor shall furnish a day tank for each engine, each with a capacity of not less than 300 gallons. The day tank shall be installed as shown on the drawings.

The contractor shall furnish and install a fuel oil meter, Trident, Hersey, or approved

equal, for metering the fuel oil from the tank car to the storage tank. The contractor shall also furnish a meter for each day tank which will record the amount of oil delivered from the storage tank to each day tank. The master meter shall be of such size that it will have a capacity of not less than 35 gpm and the day tank meters shall have a capacity of not less than 15 gpm. The fuel meters shall be located so as to be easily accessible for readings. The dials shall be direct reading and shall indicate gallons. They shall measure with an accuracy within 1% plus or minus, the minimum and maximum flows under any operating conditions. Master meter must be equipped with a separate strainer, with perforated plate and 40 mesh screen readily accessible for cleaning. [46]

The contractor shall have included in his bid the furnishing and installing 1,500' of 2" fuel oil pipe line which shall extend from the fuel storage tank to the railroad siding. This pipe shall be installed as directed by the engineer. The bidder shall determine before submitting bid the approximate location of his pipe line and shall bid accordingly. The bidder shall also include in his proposal an alternate to be added or deducted per foot if the line shall be more or less than 1,500' in length. He shall also furnish not less than 15' of 2" flexible hose line designed to handle fuel oil, and furnish and in-

stall all necessary piping and connections to the fuel oil storage tank, and for attachment to tank cars. Piping arrangements must also be made to receive fuel oil from trucks.

The fuel oil line shall be of 2" genuine galvanized iron pipe and shall be installed not less than 20" below the ground level.

The contractor shall furnish and install 2 fuel oil transfer pumps, which shall be motor driven. The transfer pump shall be either a centrifugal or rotary as the contractor recommends and shall have a capacity of not less than 1500 gallons per hour. The motor shall be of sufficient size to not be overloaded under the anticipated pumping head and shall be furnished with an across-the-line starter with push button control, complete with necessary wiring.

It is expected that the Diesel engine will be furnished with a built-in fuel pump for transferring the oil from the day tank to the engine. Otherwise, a separate fuel transfer pump must be furnished by the contractor.

Each fuel day tank shall be equipped with a gauge so that the level in the tank can be determined from the engine room. The gauge shall be mounted on the wall as directed by the engineer and shall be similar to a levelometer.

The fuel oil storage tank shall be equipped with a Viking or equal level indicator, with the indicator mounted on the gauge panel or on the wall as directed by the Engineer.

The contractor shall furnish and install the complete piping for the entire power plant, which shall include the cooling system, fuel oil system, lubricating oil system, air start system, necessary pressure and temperature gauges, etc., together with connections to the city water supply and the sewer. The contractor shall determine from the engineer the best location for connecting to the city water supply and to the city sewer.

All piping 4" and larger shall be flanged and smaller than 4" may be screwed. All piping shall be installed in the pipe trench as shown where possible, otherwise it shall be installed under the floor. All piping installed under the floor shall be cast iron, where not in accessible pipe trench or tunnel. All valves shall be Crane or approved equal.

The piping system shall be furnished complete with all necessary hangers, anchors and supports and shall be complete with sufficient unions to conveniently allow dismantling. It is the intention of these drawings to show a standard piping layout, but the contractor will be required to furnish the complete piping system as required for the engine bid upon.

The contractor shall furnish a chain hoist and trolley for each engine, which shall be placed on the "I" beam above the engine as shown on the drawing. The chain hoist shall be

similar to the tri-bloc as manufactured by the Ford Chain Block Co., or the Cyclone as manufactured by the Chisholm-Moore Hoist Company or approved equal. The trolleys shall be a plain type trolley as manufactured by these companies and shall be of ample capacity to handle with ease the load to be imposed upon them.

The contractor shall furnish and install a gauge panel as directed by the engineer. The panel shall be of stretcher level steel to match the panels specified in these specifications under "switchboard". The panels shall not be less than 76" high, 30" wide and mounted on a frame to be self-supporting. [47]

On this panel shall be mounted the following instruments:

Raw water pressure gauge—electric alarm
Soft water pressure gauge—electric alarm
Surge tank pressure gauge—electric alarm
Soft water temperature gauge—electric alarm
Lubricating oil pressure gauge—electric alarm (to be furnished if engine requires pressure lubrication.)

Pyrometer—(as specified under paragraph entitled "exhaust".)

Starting air pressure gauge

Fuel Oil pressure gauge

Jacket water gauge, Temperature indicating

Lubricating oil gauge, Temperature indicating

All of the above gauges shall be of a diameter of not less than 6" and shall be furnished with a cromium flared ring. They shall be similar to those furnished by the Marshalltown Manufacturing Company.

The gauge panel shall be furnished complete with the necessary relays, a Klaxen horn, and all necessary back of board wiring so connected that the electric alarm gauges will sound the Klaxen horn on both high and low limits.

Certain of the above instruments may be mounted on an individual gauge panel for each engine, if equipment offered requires such installation.

There shall be furnished and installed a tool and work bench, with drawers and two shelves for storing tools and supplies, a circuit with switches, etc., for proper meter testing, and a full supply of all special tools needed or convenient for any of the equipment.

Contractor shall connect the existing water plant mixing chamber overflow line to the existing filter waste line, under the floor of the power plant building. This will require two 8" short-sweep cast iron ells, a "cut-in" 12"x8" tee, and 28' of 8" class 100 cast iron pipe.

Rinse water from the water softener and overflow water from the surge tank, may be discharged to this line. All other drainage, sewerage and other waste water, must be disposed of to the City sanitary sewer.

The contractor shall furnish and install 2-2qt. and 1-1qt., fire extinguishers, Fyr-Fyter or approved equal.

All steel floor plates shall be equipped with Tapax or approved equal gaskets under all bearing edges.

Each Diesel engine shall be furnished with a direct connected engine type alternator of a size to deliver the complete capacity of the engine with which it will be mounted. The exact size of the alternator will depend upon the size of the engine offered, and shall be approximately of the following sizes, depending upon the standard sizes of the engines offered:

Unit No. 1—300 HP—200 KW

Unit No. 2—375 HP—250 KW

Unit No. 3—450 HP—300 KW

In no event shall the total kilowatt capacity of the plant be less than 750 kilowatts.

The alternators shall be designed to operate at 2400 volts, 3 phase, and 80% power factor. They shall be designed to deliver 60 cycle current when operating at the engine speed and shall be constructed in accordance with the AIEE specifications.

If the generator is furnished by other than the engine manufacturer, [48] the generator manufacturer must co-operate with the engine manufacturer in order to insure the proper mounting of the alternator on the engine manu-

manufacturer's extension shaft. The engine manufacturer shall be entirely responsible for the satisfactory operation of the alternator and exciter regardless of the manufacturer. The alternator shall be designed to operate in parallel.

The contractor shall furnish an exciter for each generating unit of ample capacity to easily excite the alternator field under all possible operating conditions. It is expected that at normal operating conditions the power factor will not be less than 60%. Under these conditions the exciter must be able to handle full load KVA rating of the alternator. The exciter shall be driven from the engine extension shaft by a V-belt or silent chain drive of ample capacity to insure long life. The exciter shall operate at a speed of not more than 1750 rpm and shall be rated at a normal voltage of 125 volts.

The contractor shall furnish a concentric rheostat for each unit, one for the alternator and one for the exciter. These rheostats shall be mounted on the switchboard by the contractor.

The contractor shall guarantee to the owner that the three generating units to be furnished under these specifications will satisfactorily parallel.

The alternator and exciter construction shall be in accordance with the best practice known

to the trade pertaining to the respective parts of the equipment. The construction shall be such that the alternator shall be free of excessive noises.”

That it was known to said defendants at the time of and prior to the advertisement for bids that the defendant Fairbanks, Morse & Co. is the only concern that manufactures, or is prepared to manufacture or produce, the type of Diesel engine, with the equipment, provided for in said specifications. That there are other manufacturing establishments and concerns manufacturing and producing Diesel engines, with power efficiency and cost of operation, equal to the Diesel engines specified.

Dated July 26th, 1940.

TOOMEY, McFARLAND & CHAPMAN
GUNN, RASCH, HALL & GUNN

By M. S. GUNN

A member of said Firm.

Residence and Post Office Address:
Helena, Montana.

Attorneys for Plaintiff.

[Endorsed]: Filed July 27, 1940. C. R. Garlow,
Clerk. [49]

Thereafter, on June 25, 1940, a Stipulation was filed herein, being in the words and figures following, to wit: [50]

[Title of District Court and Cause.]

STIPULATION

Whereas, the plaintiff has made an application for a preliminary injunction herein:

Now, therefore, it is hereby stipulated that the defendant, the City of Forsyth, will not, pending the final decision of this case on the merits, remove any of the poles or wires of plaintiff from the streets and alleys of said city, or in any manner interfere with the electric plant or system of plaintiff, or the operation of same, and it is further stipulated that the defendant, Fairbanks, Morse & Co., will refrain, pending the final decision of this case on the merits, from constructing the proposed electric plant or system for said City, or any part thereof, and that an order may be made and entered herein accordingly.

Dated this 19th day of June, 1940.

TOOMEY, McFARLAND & CHAPMAN
GUNN, RASCH, HALL & GUNN

By M. S. GUNN

A Member of said Firm.

Residence and Post Office Address:
Helena, Montana.

Attorneys for Plaintiff.

F. F. HAYNES

Residence and Post Office Address:
Forsyth, Montana.

KYLE & KYLE

St. Paul, Minnesota

Attorneys for Defendants.

[Endorsed]: Filed June 25, 1940. C. R. Garlow,
Clerk. [51]

Thereafter, on July 22, 1940, Order Pursuant to Stipulation was duly filed and entered herein, being in the words and figures following, to wit: [52]

[Title of District Court and Cause.]

ORDER

Whereas, a stipulation has been entered into and filed by the parties hereto wherein and whereby it is stipulated that the defendant, the City of Forsyth, will not, pending the final decision of this case on the merits, remove any of the poles or wires of plaintiff from the streets and alleys of said city, or in any manner interfere with the electric plant or system of plaintiff, or the operation of same, and it is further stipulated that the defendant, Fairbanks, Morse & Co., will refrain, pending the final decision of this case on the merits, from constructing the proposed electric plant or system for said City, or any part thereof, and that an order may be made and entered herein accordingly.

Now, therefore, it is ordered that the defendants and each of them observe and abide by the provisions of said stipulation, and are hereby enjoined and restrained accordingly.

Dated this 22 day of July, 1940.

CHARLES N. PRAY

Judge

[Endorsed]: Filed and entered July 22, 1940.
C. R. Garlow, Clerk. [53]

Thereafter, on December 18, 1940, a Motion, and Notice Thereof, for Judgment on the Pleadings was duly filed herein, being in the words and figures following, to wit: [54]

[Title of District Court and Cause.]

MOTION

The plaintiff moves the Court for judgment in its favor on the pleadings because the answer fails to state any defense in law or in fact to the cause of action stated in the complaint.

GUNN, RASCH, HALL & GUNN

E. G. TOOMEY

Address: Helena, Montana

Attorneys for Plaintiff

To F. F. Haynes and Kyle & Kyle, Attorneys for Defendants:

Please take notice that the undersigned will bring the above motion on for hearing before the Court in the Court Room, in the Federal Building, in Billings, Montana, where the above-entitled Court is held, at 10:00 o'clock in the forenoon of the day when said Court next convenes in Billings, or as soon thereafter as a hearing can be had.

GUNN, RASCH, HALL & GUNN

E. G. TOOMEY

Address: Helena, Montana

Attorneys for Plaintiff

[Endorsed]: Filed Dec. 18, 1940. C. R. Garlow, Clerk. [55]

Thereafter, on July 16, 1941,

DECISION OF THE COURT

was duly filed herein, being in the words and figures following, to wit: [60]

[Title of District Court and Cause.]

The questions presented here arise over a motion by plaintiff for a judgment on the pleadings in its favor for the reason that the answer filed herein "fails to state any defense in law or in fact to the cause of action stated in the complaint."

By this action plaintiff seeks an injunction to enjoin the defendant City of Forsyth, Montana, from entering into a contract with the defendant Fairbanks, Morse & Company, for the construction of a municipal electric lighting, heating and power plant, or, if said contract has been entered into, enjoining the defendant last named from constructing such plant.

From the complaint it appears that plaintiff is, and has been for several years, the owner of an electric light and power plant or system in said city, consisting in part of poles and wires in the streets and alleys of said city, and engaged in furnishing electric light and power to said city and the inhabitants thereof at rates prescribed by the Public Service Commission of Montana; that said plant or system was constructed by the predecessor in interest and ownership of the plaintiff. That the city authorities proposed to construct a municipal

electric light, heat and power plant, and for that purpose entered into a contract with the defendant construction company for furnishing and constructing such a plant in and for said city, for the sum of \$169,969.00, payable in monthly installments, with interest at the rate of 5 per cent per annum, solely out of the net earnings of said plant, in accordance with the plans and specifications and bid of said defendant construction company. That an election was held for the approval of the tax-paying electors of said city, and that the proposed contract at such election [61] was approved by a majority vote. The complaint alleges, in paragraph VIII, that the city under said contract is assuming to exercise power and authority conferred by Chapter 115 of the Laws of Montana of 1937, as amended by Chapter 111 of the Laws of Montana of 1939. The answer alleges that the city in entering into said contract is proceeding under authority conferred upon it by the decisions of the Supreme Court and statutes of Montana, including the statutes referred to in paragraph VIII of the complaint. The answer further alleges that the present plant was constructed and first operated pursuant to a franchise granted by the city, but that such franchise has expired, and that plaintiff is now occupying the streets and alleys solely during the will and pleasure of the city.

The jurisdictional amount alleged in the complaint is denied in the answer, but the admission further appears in the answer of the amount in-

volved in the construction of the municipal electric plant and, according to the authorities cited, that is sufficient to determine the question of jurisdiction, which seems to be the value of the object sought to be attained in this litigation. Without discussing the question minutely as set forth in the voluminous briefs of counsel, it seems quite clear that plaintiff has a franchise (Sec. 6645, R. C. M. 1935), although one that is not exclusive, and, as contended by defendants, one that could not prevent the city from constructing its own plant and operating in competition with plaintiff, to which the rule of "*damnum absque injuria*" might apply. But plaintiff contends that if the City is without authority to make such a contract then the injunctive relief sought should be granted irrespective of the fact that its franchise is not exclusive, so that the decision here seems to rest upon the authority of the city to act in the manner contemplated by its contract, in other words, whether it has entered into a valid contract with the construction company, although authorized by a majority of the tax-paying voters so to do.

It was held that the holder of a franchise to operate an electric light plant, although not exclusive, would be protected against the [62] illegal acts of others attempting to exercise the same privilege conferred by the franchise, and against illegal competition. (*Arkansas-Missouri Power Co. v. City of Kennett*, 78 Fed. (2) 911; *Frost v. Corporation Commission*, 278 U. S. 515; *City of Campbell v.*

Arkansas-Mo. Power Co., 55 Fed. (2) 560.) Is it a legal and binding contract. Section 5039.63, in so far as applicable here, reads as follows: "The city or town council has power: To contract an indebtedness on behalf of a city or town, upon the credit thereof, by borrowing money or issuing bonds for the following purposes, to wit: * * * Erection of * * * lighting plants."

Defendants contend that borrowing money or issuing bonds, as provided by the statute, is permissive only and does not prohibit the city from entering into the contract under consideration; opposed to this view is the contention of plaintiff that where a statute authorizes a city to acquire a lighting plant, upon the credit of the city, by borrowing of money or issuing of bonds, such method is exclusive, and this latter contention would seem to be sustained by the greater weight of authority as will appear from an examination of the authorities cited by counsel for both sides, and also by the recent well reasoned case of *Whipps, Sr., v. The Town of Greybull, Wyoming*, decided by the Supreme Court of Wyoming February 4th, 1941. Where the statute prescribes the mode of exercising the power it must be pursued in all substantial particulars. (*Shapard v. City of Missoula*, 49 Mont. 269.)

The court has considered the supplemental brief of plaintiff in which it contends that the contract in question is also unenforceable and invalid because of want of mutuality. The contract provides that:

“The contractor will not be required to begin work until ten days after litigation for the ousting of the power company now serving the city from its streets has been finally determined in favor of the city.” In another paragraph of the contract the city promises promptly to institute legal action to have it determined that the plaintiff has no right to use or occupy the streets, alleys or public grounds of the city with poles, wires or other instrumentalities, and that it be required to remove all its equipment therefrom. If the [63] court is correct in holding that plaintiff has a franchise then the contractor would not be obliged to construct the plant since the plaintiff could not be ousted as promised by the city in the contract. If the contract is invalid then a new contract could not be made with this or any other contractor by the defendant city for the construction of the plant since it appears that the statute under which it claimed authority to act expired March 15th, 1941. (Chap. 115 Laws of 1937; Chapter 111 Laws of 1939.) It is quite evident from the terms of the contract that authority was not given the city by the voters to construct and operate a plant in competition with plaintiff, but upon the assurance, to be strongly inferred from the language of the contract, that plaintiff would be ousted from the city and required to remove all its equipment.

The contractor does not have to begin work until ten days after the final determination of the court that plaintiff is to be ousted. Such a contract would

seem to come within the rule relied upon by plaintiff's counsel. Mutuality of obligation is an essential element of every enforceable contract. Mutuality is absent when one only of the contracting parties is bound to perform, and the rights of the parties exist at the option of one only. (13 C. J. 331). Each party must have the right at once to hold the other to a positive agreement. Counsel cited a decision by Judge Hunt in Pocatello v. Fidelity & Deposit Co., 267 Fed. 161, C. C. A. 9, which appears to be precisely in point.

In discussing the effect of the repeal of a statute reference was made to 59 C. J. pgs. 1185 and 1187, which provides in part that "the repeal of a statute does not operate to impair or otherwise affect rights that have been vested or accrued while the statute was in force. This rule is applicable alike to rights acquired under contracts and to rights of action to recover damages for torts."

Aside from the lack of authority to enter into such a contract on the part of the city, it would now appear from the argument of counsel for plaintiff, to which there has been no reply, that the [64] contract itself is invalid and unenforceable, thereby claiming an additional reason why plaintiff should prevail. Counsel for defendants have presented an able discussion of the problems involved, which in some respects are difficult of solution, but if the court is in error, it is not one that can not be speedily corrected.

As may be inferred from the foregoing views the Court was not impressed with the argument of counsel declaring Chapter III of the laws of 1939 unconstitutional, but on the other hand it may also be inferred that the court does not believe that this Chapter has any application to the present controversy, or the material questions here raised, nor does it supercede or modify in any respect the plain and specific mandatory provisions of Section 5039. 63 R. C. M.

Wherefore, being duly advised and good cause appearing therefor, in the opinion of the court the plaintiff should prevail in its motion, and it is so ordered.

CHARLES N. PRAY

Judge

[Endorsed]: Filed July 16, 1941. C. R. Garlow,
Clerk. [65]

Thereafter, on July 21, 1941, Judgment was duly entered herein, being in the words and figures following, to wit. [66]

In the District Court of the United States for the
District of Montana, Billings Division

MOUNTAIN STATES POWER COMPANY,
Plaintiff,

vs.

CITY OF FORSYTH, and FAIRBANKS,
MORSE & CO.,

Defendants.

JUDGMENT

This cause came on to be heard upon the plaintiff's motion for judgment on the pleadings in its favor and was argued by the attorneys for the respective parties; and thereupon, after due consideration thereof, it was ordered, adjudged and decreed, as follows, namely:

1. That the said motion of plaintiff for judgment on the pleadings in its favor be and the same is hereby sustained.

2. That the preliminary injunction issued pursuant to stipulation of the parties be made permanent, and the defendants be and they are hereby enjoined from removing any of the poles or wires of plaintiff's electric plant or system in the City of Forsyth, Montana, from the streets and alleys of said City of Forsyth, or from in any manner interfering with said plant or system, or the operation of the same, and that the defendant, Fairbanks, Morse & Co., is hereby enjoined from constructing

an electric light, heat and power plant within said City for the reasons:

(a) That the plaintiff has a valid and existing franchise for the maintenance and operation of its electric plant and system in said City.

(b) That the contract between the said City and the defendant Fairbanks, Morse & Co., for the construction of a municipal light, heat and power plant, is invalid.

(c) That the construction and operation of such a municipal plant, according to the terms and provisions of said contract, would constitute illegal competition with plaintiff's electric plant and system. [67]

3. That the plaintiff recover its costs herein taxed herein taxed at the sum of \$10.00.

Dated this 21st day of July, 1941.

CHARLES N. PRAY

Judge

[Endorsed]: Filed and entered July 21, 1941.
C. R. Garlow, Clerk. [68]

Thereafter, on October 7, 1941,

NOTICE OF APPEAL

was duly filed herein, in the words and figures following, to wit: [69]

[Title of District Court and Cause.]

Notice is hereby given that the City of Forsyth and Fairbanks, Morse & Company, defendants in

the above entitled action, hereby appeal to the Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in the above action on the 21st day of July, 1941, and from the whole of said judgment.

Dated this 30th day of September, 1941.

H. V. BEEMAN

Attorneys for city of Forsyth,
Montana

Residence & Address: Forsyth,
Mont.

KYLE & KYLE

Attorneys for Fairbanks,
Morse & Co.

By JOHN P. KYLE

One of said Attorneys
Residence: St. Paul, Minnesota
Address: 618 Guardian Building,
St. Paul, Minnesota

[Endorsed]: Filed October 7, 1941. C. R. Garlow,
Clerk. [70]

CLERK'S CERTIFICATE TO TRANSCRIPT
ON APPEAL

United States of America,
District of Montana—ss.

I, C. R. Garlow, Clerk of the United States District Court for the District of Montana, do hereby certify and return to The Honorable, The United

States Circuit Court of Appeals for the Ninth Circuit, that the foregoing volume consisting of 87 pages, numbered consecutively from 1 to 87 inclusive, constitutes a full, true and correct transcript of all portions of the record in case Number 183, Mountain States Power Company, Plaintiff, vs. City of Forsyth, and Fairbanks, Morse & Co., Defendants, designated by the parties as the record on appeal therein, as appears from the original records and files of said court in my custody as such Clerk.

I further certify that the costs of said transcript amount to the sum of Eighteen and 55/100 Dollars (\$18.55) and have been paid by the appellants.

Witness my hand and the seal of said court at Great Falls, Montana, this 26th day of November, A. D. 1941.

(Seal)

C. R. GARLOW,

Clerk U. S. District Court,

District of Montana,

By C. G. KEGEL,

Deputy. [87]

[Endorsed]: No. 9990. United States Circuit Court of Appeals for the Ninth Circuit. The City of Forsyth, a municipal corporation of The State of Montana and Fairbanks, Morse & Company, a corporation, Appellants, vs. Mountain States Power Company, a corporation, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the District of Montana, Billings Division.

Filed December 5, 1941.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit

No. 9990

CITY OF FORSYTH and FAIRBANKS,
MORSE AND COMPANY,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY,
Appellee.

STATEMENT OF POINTS AND DESIGNA-
TION OF PARTS OF RECORD TO BE
PRINTED

I.

STATEMENT OF POINTS

The following is a statement of the points upon which Appellants intend to rely on this appeal:

(1) It appears upon the face of the pleadings that the District Court had no jurisdiction of the action, because:

(a) The allegation in the complaint that the amount in controversy exceeds Three Thousand dollars exclusive of costs is denied by the answer.

(b) The amount in controversy in this action is not the amount of the contract between the city of Forsyth and Fairbanks, Morse & Company, namely, \$169,960.00, for the *the* construction of the municipal light plant.

(c) The amount in controversy in this case is not the right of the city of Forsyth to construct a

municipal electric plant at a cost of \$169,960.00, and even if it were, the value of such right to the city is not alleged. The value is not the cost of installation, because that is a disbursement.

(d) The amount in controversy in this case is not the value of the privilege of constructing the municipal light plant of which Fairbanks, Morse & Company will be deprived, nor is the value of such privilege alleged. The cost of construction is not the value of such privilege.

(e) The pleadings do not show, nor is it claimed, that the Appellee has an exclusive franchise in the city of Forsyth, and therefore the establishment of a municipal light and power plant by said city is as to the Appellee *damnum absque injuria*.

(2) The Appellee has no standing in Court to maintain this action in its personal capacity.

(3) The Appellee has no standing as a taxpayer to maintain this action, because:

(a) The action is not brought in a representative capacity as a taxpayer, for the benefit of all taxpayers.

(b) There is no allegation in the complaint that the Appellee is damaged as a taxpayer to any amount whatsoever.

(c) The contract entered into between the city of Forsyth and Fairbanks, Morse & Company is not payable out of taxation, but solely out of the earnings of the municipal light and power plant to be established, and therefore no taxpayer is damaged.

(4) The Appellee has not, nor had it at the time of the commencement of this action, any franchise to maintain or operate a light and power plant in the city of Forsyth, and the Appellee was at the time of the commencement of this action and now is, occupying the streets of said city on sufferance.

(5) Section 6645 of the General Statutes of Montana for 1935 does not confer upon the plaintiff an exclusive franchise, or a perpetual franchise.

(6) Chapter 115 of the Session Laws of the State of Montana for the year 1937 is not unconstitutional.

(7) Chapter 111 of the Session Laws of the State of Montana for the year 1939 is not unconstitutional.

(8) This action cannot be brought or maintained in a dual capacity, that is to say, to vindicate the private rights of the plaintiff, and to vindicate the public rights of taxpayers, and an action for both purposes cannot be joined.

(9) The complaint is not susceptible of amendment to give the Federal District Court jurisdiction because the Appellee is not legally damaged by the installation and consequent competition of the municipal light and power plant by the city of Forsyth.

(10) The city of Forsyth has authority to establish and maintain a municipal light, heat and power plant under the statutes and decisions of the State of Montana.

(11) The city of Forsyth has authority to make

a contract for the installation and construction of a municipal light and power plant which is payable out of the earnings of the plant itself, and which imposes no general obligation on the city.

II.

DESIGNATION OF THE PARTS OF THE RECORD TO BE PRINTED

The Appellants hereby designate the following parts of the record as the parts thereof to be printed as necessary for the consideration of the points of the Appellants above specified:

1. The Complaint, designated as such in the certified transcript of the record herein, consisting of seven pages, and a fraction, together with exhibits A and B attached thereto.

2. The Answer of the defendant, city of Forsyth, designated as such in the transcript of the record, consisting of three pages, together with Exhibit A attached thereto.

3. The plaintiff's motion for judgment on the pleadings and the Notice for Hearing thereon, designated as "Motion" upon the certified transcript of the record herein.

4. The decision of the trial Court by Charles N. Pray, Judge, bearing date July 16, 1941, designated as 183 Civil, consisting of four pages, and a fractional part of a page, and winding up with an order granting the motion.

5. The judgment entered in said action, bearing date the 21st day of July, 1941, consisting of one

page and a fractional part of a page, and designated as "Judgment."

6. The Notice of Appeal, consisting of one page, and designated as No. 183 Civil, said Notice bearing date the 30th day of September, 1941.

H. V. BEEMAN

Residence and Business Address: Forsyth, Montana.

KYLE & KYLE

By JOHN P. KYLE

Residence: St. Paul, Minnesota.

Business Address: 614-618
Guardian Bldg., St. Paul,
Minn.

Attorneys for Appellants.

To Toomey, McFarland & Chapman, and Gunn,
Rasch & Gunn, Attorneys for Appellee:

You Are Hereby Notified That the foregoing are the statement of points of the Appellants which they intend to urge upon the Appellee in the above entitled action, and a designation of the parts of the record which they desire to have printed for the consideration of said points.

You are hereby notified to designate such other parts of the record as you may deem material or necessary for the consideration of said points.

Dated this 29th day of November, 1941.

H. V. BEEMAN

Residence and Post Office Address: Forsyth, Montana.

KYLE & KYLE

By JOHN P. KYLE

Residence: St. Paul, Minnesota.

Business Address: 614-618
Guardian Bldg., St. Paul,
Minnesota.

Attorneys for Appellants.

State of Minnesota,
County of Ramsey—ss.

Esther P. McEvoy, being first duly sworn, on oath deposes, and says:

That heretofore, to-wit, on the first day of December, 1941, at the City of St. Paul, Minnesota, she served the attached Statement of Points, Designation of Parts of Record to be Printed, and Notice to Designate such additional parts of the record as the said attorneys may deem necessary on said appeal, upon the attorneys for the appellee by then and there depositing in the Post Office in the city of St. Paul, Minnesota, enclosed in a sealed envelope with postage thereon prepaid, a true and correct copy of said Statement of Points, Designation of Parts of Record to be Printed and Notice to Designate such additional parts of the record

as the said attorneys may deem necessary on said appeal, and addressed to said attorneys as follows:

“Toomey, McFarland & Chapman, and
Gunn, Rasch & Gunn,
Securities Building,
Helena, Montana.”

That said attorneys are the attorneys of record for the said appellee and that their address is given as above stated.

ESTHER P. McEVOY

Subscribed and sworn to before me this first day of December, 1941.

(Seal) JOHN P. KYLE

Notary Public, Ramsey County, Minn.

My commission expires April 9, 1944.

[Endorsed]: Filed Dec. 5, 1941. Paul P. O'Brien,
Clerk.

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION BY APPELLEE OF PARTS
OF RECORD TO BE PRINTED

The Appellee hereby designates the following parts of the record as the parts thereof to be printed as necessary for the consideration by the Court of the statement of points upon which Appellants intend to rely, and complete consideration of the matters involved on the appeal, to-wit:

(1) The Separate Answer of the Defendant
(Appellant) Fairbanks, Morse and Company,

designated as such in the transcript of the record, together with all exhibits attached thereto.

(2) The Demand of the Defendants (Appellants) for a Bill of Particulars designated as such in the transcript of record.

(3) The Order of the Court requiring the furnishing of a Bill of Particulars, designated as such in the transcript of the record.

(4) The Bill of Particulars furnished by the Plaintiff (Appellee) to the Defendants (Appellants) designated as such in the transcript of the record.

(5) The Stipulation of Plaintiff (Appellee) and Defendants (Appellants) to refrain from removing poles, etc., pending final decision.

(6) The Order of the Court enjoining Defendants (Appellants) pending final decision from removing poles, etc., and from constructing the proposed electrical plant.

The Clerk of the United States District Court for the District of Montana (at Great Falls, Montana) advises the undersigned that the original certified record, forwarded by that Clerk to the Clerk of the Circuit Court of Appeals for the Ninth Circuit at San Francisco, California, does not contain reference to the above papers and documents, by page number on said record, and there is no copy of the index on file in the office of the Clerk of the United States District Court for the

District of Montana at Great Falls, or at Helena, Montana.

GUNN, RASCH & GUNN,
By M. S. GUNN
Helena, Montana
TOOMEY, McFARLAND &
CHAPMAN
By E. G. TOOMEY
Helena, Montana.
Attorneys for Appellee

To Messrs. Kyle & Kyle, 614-618 Guardian Building, St. Paul, Minnesota, and to H. V. Beeman, Esq., Attorney at Law, Forsyth, Montana, Attorneys for Appellants:

You are hereby notified that the foregoing constitutes the designation by the Appellee of the parts of the record which it desires to have printed, IN ADDITION to the parts of the record heretofore designated by Appellants to be printed.

Done and dated this 8th day of December, 1941.

GUNN, RASCH & GUNN,
By M. S. GUNN
Helena, Montana
TOOMEY, McFARLAND &
CHAPMAN
By E. G. TOOMEY
Helena, Montana

[Endorsed]: Filed Dec. 10, 1941. Paul P. O'Brien, Clerk.



No. 9990

11

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

CITY OF FORSYTH and FAIRBANKS, MORSE & COMPANY,
Appellants,

vs.

MOUNTAIN STATES POWER COMPANY,
Appellee.

APPELLANTS' BRIEF.

H. V. BEEMAN,
Attorney for City of Forsyth,
Residence and Post Office Address:
Forsyth, Montana.

KYLE & KYLE,
Attorneys for Fairbanks, Morse & Company,
Residence: St. Paul, Minnesota.
Post Office Address: 618 Guardian Bldg.

POPPENHUSEN, JOHNSTON, THOMPSON
& RAYMOND,

of counsel,
Chicago, Illinois.

FILED

JAN 31 1942

PAUL P. O'BRIEN,
CLERK



SUBJECT INDEX.

	Page
Statement of Case	1
Statement of Pleadings	2- 9
Admitted Allegations therein	2- 5
Denials of Answers	5- 8
New Matter in Answers	9
Specification of Errors	9-11
Summary of Points and Authorities	11-18
Contract does not create indebtedness	11
Appellee has no exclusive franchise	11
I. Error in granting appellants' motion for judgment on the pleadings	11
(a) Allegation of jurisdictional amount denied	11
(b) Purchase price of the electric light plant not amount in controversy...	12
(c) Appellee's loss is <i>damnum absque injuria</i>	12
(d) Appellee has no standing to main- tain the action	13
(e) Appellee has no standing to main- tain action even if contract is <i>ultra vires</i>	14
(f) Appellants' contract not illegal com- petition	15
II. Contract between City and Fairbanks, Morse & Company not invalid	15
Section 5039.63, Statutes of Montana— A grant of power not a limitation...	15

Right of City to acquire plant on credit payable out of earnings	16
Contract not lacking in mutuality	16
III. Appellee has no franchise	17
IV. Errors in holding competition of City illegal. Even if illegal appellee has no standing to maintain the action	18
Argument	18-62
I. a. Court has no jurisdiction	18
b. Purchase price of electric light plant not amount or matter in controversy	19
Appellee no right to be free of competi- tion	20
Test of jurisdiction	20-23
c. Appellee's loss or damage <i>damnum absque injuria</i>	23
d. Appellee no standing to maintain the ac- tion	23
e. Appellee no standing to maintain the ac- tion even if contract is <i>ultra vires</i>	23
f. Error in holding appellants' proposed plant illegal competition	24-30
II. Contract between City and Fairbanks, Morse & Company not invalid	30-50
Provisions of Section 5039.63—A grant of power not a limitation	30
Method of acquiring municipal lighting plants by conditional sales contract pay- able out of earnings in common use....	31-32
Other powers of City	33

Montana decision on power to install lighting plant	33
Power to provide for lighting streets authorizes establishment of plant	33
City may establish plant as incident to police power	34-35
Inherent power to light streets and supply light to inhabitants	36
Proprietary powers, City exercising in establishing plant	36-37
Authority to acquire property includes any mode not prohibited	37
City may purchase on credit	38
Power under Section 5039.63 not exclusive, discussed	38-44
Whipps v. Town of Greybull and cases cited discussed	45-49
Contract not lacking in mutuality	50
III. Error in holding appellee has a franchise...	51-61
Section 6645 of the Revised Codes of the State of Montana, discussed	51
Reserved powers of City Councils discussed.	51-53
Powers of City over streets	51-53
Power to grant franchises	52
Method of granting franchises	52
Powers not repealed but reserved	52
Grant by State to use streets requires consent of municipality	52
Powers reserved to City of Forsyth not mere police powers	53

Powers reserved are powers of control, prevention and prohibition	53
Franchise, original, granted by City discussed	54
Section 6645, history of, discussed	55-61
Invalidity of restriction as to telephone companies not applicable to electric light plants, discussed	58-59
Unconstitutionality of Section 6645 as to telephone companies leaves Section constitutional as to electric light companies.	60-61
Statute may be in part constitutional and in part unconstitutional	60-61
Powers reserved to council must be given effect	61
Conclusion	62-64

TABLE OF CASES AND AUTHORITIES CITED.

	Page
Ahern, et al v. Richardson County, 127 Neb. 659, 256 N. W. 515	49
Alabama Power Company v. Ickes, 58 S. Ct. 300, 302 U. S. 464, affirming 91 F. (2d) 303	13, 14, 27, 28
A. L. R. Vol. 72, P. 687	16, 32
A. L. R. Vol. 96, P. 1385	16, 32
Barnes v. City of Lehi, 74 Utah 321, 279 Pac. 878	16
Beal v. Missouri, Pacific Railroad Co., 61 S. Ct. 418, 312 U. S. 45	9
Bell v. City of Fayette, 325 Mo. 75, 28 S. W. (2d) 356..	16, 31

Bowling Green, City of v. Kirby, 220 Ky. 839, 295 S. W. 1004	16, 31
Broad River Company v. South Carolina, 281 U. S. 543, 548, 50 S. Ct. 401	53
Buck v. Gallegher, 59 S. Ct. 704, 307 U. S. 95	11
California Toll Bridge Authority, 212 Cal. 298, 298 Pac. 485	48
Carl Fischer, Inc. v. Shannon, 26 F. Supp. 727 (D. C. Mont.)	12, 22
Carolina Power & Light Co. v. South Carolina Public Service Company, 94 F. (2d) 520	14
Carr v. Fenstermacher, 119 Neb. 172, 228 N. W. 114	15, 31, 39, 41, 48
Clarke v. City of Los Angeles, 160 Cal. 30, 116 Pac. 722	13
Colony Coal & Coke Corporation v. Napier, 28 F. Supp. 143	12, 22
Colorado Life Company v. Steele, 99 F. (2d) 535..	14, 23, 29
Crawfordsville v. Braden, 130 Ind. 149, 28 N. E. 849 ..	36
Davies v. Village of Madelia, 205 Minn. 526, 287 N. W. 1	31
Duke Power Company v. Greenwood, 91 F. (2d) 665	13, 14, 29
Dunn v. City of Great Falls, 13 Mont. 58, 31 Pac. 1017	60
Electro Therapy Products Corporation, Ltd. v. Strong, et al, 84 F. (2d) 766	12, 21
Fairbanks, Morse & Company v. City of Wagoner, 86 F. (2d) 288	49
Farmers & Merchants State Bank v. City of Conrad, 100 Mont. 415, 47 Pac. (2d) 853.....	15, 16, 39, 44
Faulkner v. Seattle, 19 Wash. 320, 53 Pac. 365	16, 31
Franklin Trust Co. v. City of Loveland, 3 F. (2d) 114.	16, 32

Gavica v. Donough, U. S. Attorney, (C. C. A. 9th Cir.)	
93 F. (2d) 173	12, 21
Georgia Power Co. v. Tennessee Valley Authority, 14	
F. Supp. 673	13
Gibbs v. Buck, 307 U. S. 66, 59 S. Ct. 725	12, 22
Glenwood L & W Co. v. Mutual etc. Co., 239 U. S. 121,	
36 S. Ct. 30	12
Green v. Tacoma, 57 F. 562	11
Greenwood County v. Duke Power Company, 81 F.	
(2d) 986, 987	14, 29
Hague v. Committee for Industrial Organization, 307	
U. S. 496, 59 S. Ct. 954	11
Healy v. Ratta, 292 U. S. 263, 54 S. Ct. 700	12
Hesse v. City of Watertown, 57 S. D. 325, 232 N. W.	
53	48
Illinois Trust & Savings Bank v. City of Arkansas, 76	
F. 271, 22 C. C. A. 171	36
Interstate Power Company v. Ainsworth, 125 Neb. 419,	
250 N. W. 649	47
Johnston v. City of Stuart, 226 (Ia.) N. W. 164..16, 31, 47	
Juett v. The Town of Williamstown, 248 Ky. 235, 58	
S. W. (2d) 411	34
Kelly v. Merry, 262 N. Y. 151, 186 N. E. 425.15, 16, 32, 39, 42	
Kroger Grocery & Baking Co. v. Lutz, 299 U. S. 300, 57	
S. Ct. 215	11, 12
Kurn v. Beasely, 109 F. (2d) 687	12
KVOS, Incorporated v. Associated Press, 299 U. S. 269,	
57 S. Ct. 197	11
Lang v. City of Cavalier, 59 N. D. 75, 228 N. W. 819	
.....	15, 31, 39
Larson v. State of South Dakota, 278 U. S. 429, 49 S.	
Ct. 196, affirming 251 N. W. 880, 51 S. D. 561	13

Lassen Municipal Utility District v. Hopper, 5 Cal. (2d) 18, 53 Pac. (2d) 347	48
McNutt v. General Motors Acceptance Corporation, 298 U. S. 178, 56 S. Ct. 780	11, 12, 18, 20
Memphis Power & Light Co. v. City of Memphis, 172 Tenn. 346, 112 S. W. (2d) 618	14
Miller v. First Service Corporation, 84 F. (2d) 680 ..	12
Milligan v. Miles City, 51 Mont. 374, 153 Pac. 276..	15, 28, 33
Missouri Utility Company v. The City, 14 F. Supp. 613	13
Mitchell v. Dakota Central Telephone Co., 25 S. D. 409, 127 N. W. 582	54
Northwest Light & Power Co. v. Town of Milford, 82 F. (2d) 45	13
Overall v. Madisonville, 125 Ky. 684, 102 S. W. 278 ...	34
People v. Mancusco, 255 N. Y. 463, 175 N. E. 177	60
Reese v. Holme, 31 F. Supp. 435	12
Seaford, Town of v. Eastern Shore Public Service Co., 21 Del. Ch. 214, 191 Atl. 892	54
Searle v. Town of Haxton, 84 Colo. 494, 271 Pac. 629..	16, 31
Seward v. Bowers, 37 N. M. 385, 24 Pac. (2d) 253..	16, 32, 46
Shelton v. City of Los Angeles, 206 Cal. 544, 275 Pac. 421	48
Shields v. Loveland, 74 Colo. 27, 218 Pac. 913.....	16, 31
Snively Groves v. Florida Citrus Commission, 23 F. Supp. 600	12, 22
Southwestern Gas & Electric Co. v. City of Texarkana, 104 F. (2d) 847, Petition for Writ of Certiorari De- nied, 308 U. S. 586, 60 S. Ct. 110	13
S. S. Kresge v. Amsler, 99 F. (2d) 503	12
State, ex rel v. Arkansas, Missouri Power Company, 339 Mo. 15, 93 S. W. (2d) 887	55

State, ex rel District Court, 56 Mont. 464, 185 Pac. 157	61
State v. Great Falls, 19 Mont. 518	36
State, ex rel Crumb v. City of Helena, 34 Mont. 67...56,	59
State, ex rel Telephone Company v. Mayor, 30 Mont. 338, 76 Pac. 758	57, 58
State v. McWilliams, 335 Mo. 816, 34 S. W. (2d) 363..	49
State, ex rel Buford v. Penella Water Power Co., 87 Fla. 243	33
Swann v. Murray, 146 Ky. 148, 142 S. W. 244	36
Swanson v. City of Ottumwa, 118 Ia. 161, 91 N. W. 1048	63
Tennessee Electric Power Co. v. Tennessee Valley An- thority, 306 U. S. 118, 59 S. Ct. 366	13, 14, 24
Tierney v. Cohen, 268 N. Y. 464, 198 N. E. 225	48
Underwood v. Fairbanks, Morse & Company, 205 Ind. 316, 185 N. E. 118	16, 32
Van Eaton v. Town of Sydney, 211 Ia. 986, 231 N. W. 475	47
Ward v. City of Chicago, 342 Ill. 167, 173 N. E. 810...16,	32
Washington Water Power Co. v. City of Coeur d'Alene, 24 F. Supp. 790	14, 27
Western Public Service Co. v. Miniatar, 98 F. (2d) 844	13, 14
Western Tennessee Power & Light Co. v. City of Jack- son, 97 F. (2d) 979, affirming 21 F. Supp. 57	13
Whipps, et al v. Town of Greybull, 56 Wyo. 355, 100 Pac. (2d) 805	45
Williams v. Village of Kenyon, 187 Minn. 161, 244 N. W. 558	15, 31, 39, 40
Winston v. Spokane, 12 Wash. 524, 41 Pac. 888	16, 31
Wright v. Mutual Life Insurance Company of New York, 19 F. (2d) 117	14, 29

TABLE OF TEXTS AND STATUTES CITED.

	Page
72 A. L. R., Page 687.....	16, 32
96 A. L. R., Page 1385.....	16, 32
13 C. J., Page 13, Section 158.....	16, 50
43 C. J., Page 1338, Section 2097.....	16, 37, 38
44 C. J., Page 66, Section 2124.....	16
53 C. J., Page 642, Section 205.....	60
59 C. J., Page 639, Section 205.....	60
McQuillin on Municipal Corporations (2d. Ed.),	
Sec. 124...	41
Sec. 366...	16, 38
Sec. 1745...	17, 52
Sec. 1927...	36
Sec. 2322...	16
Sec. 2437...	30
Montana Constitution, Sec. 14, Article XV	58
Revised Codes of Montana, 1935, Sec. 4955.....	15, 32
Sec. 4958.....	15, 38
Sec. 5039.....	32
Sec. 5039.1	15, 32
Sec. 5039.4	15, 33, 39
Sec. 5039.5	51
Sec. 5039.6	33, 38
Sec. 5039.7	15, 17, 38, 51
Sec. 5039.42	17, 51
Sec. 5039.62	33, 37
Sec. 5039.63	
.....	15, 30, 32, 33, 38, 39
Sec. 5074.....	17, 52

Sec. 5075.....	17, 52
Sec. 5076.....	17, 52
Sec. 5077.....	17, 52
Sec. 6645.....	
.....	6, 17, 50, 51, 55, 61
Laws of 1937 of the State of Montana, Chapter 115, as amended by Section 10, Chapter 111, Laws of 1939.	15, 33
Laws of 1905, Chapter 55	55
Laws of 1907, Chapter 192	
Revised Code of Wyoming, 1931, Sec. 22-1601.....	45
28 U. S. C. A., Sec. 41(1)	21
U. S. Statutes at Large, Chap. 90, page 195.....	33
National Industrial Recovery Act	33

IN THE
United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

CITY OF FORSYTH and FAIRBANKS, MORSE & COMPANY,
Appellants,
vs.

MOUNTAIN STATES POWER COMPANY,
Appellee.

APPELLANTS' BRIEF.

STATEMENT OF CASE.

This is an appeal from a judgment on the pleadings in favor of appellee entered on the 21st day of May, 1941, in the District Court of the United States for the District of Montana, Billings Division, Honorable Charles N. Pray, Judge, upon the motion of the appellee, said judgment enjoining the appellant Fairbanks, Morse & Co. from constructing an electric light, heat and power plant in and for the appellant City (70-71*). It is contended by the appellants *inter alia* that the District Court had no jurisdiction to enter the said judgment because not only does it not appear upon the face of the pleadings that the District

*The figures in brackets are the pages from which the text is taken.

Court had jurisdiction, but because it affirmatively appears on the face of the pleadings that the District Court had no jurisdiction for the following reasons:

(a) Because the allegation in the complaint that "the matter in controversy exceeds, exclusive of interest and costs, the sum of \$3,000" (3) is denied by the answers (23, 31), and neither the complaint nor the answers otherwise show jurisdiction.

(b) The appellee has not any exclusive franchise to occupy the streets of the City of Forsyth with its electrical equipment; therefore no property right, legal or equitable, of the appellee is invaded, and the appellee has no standing to maintain this action.

Other questions raised in addition to those above stated are set out in the specification of errors.

STATEMENT OF PLEADINGS AND OF THE ADMITTED ALLEGATIONS THEREIN.

It is alleged in the complaint and admitted in the answers that the City of Forsyth is a Municipal corporation organized under the laws of the State of Montana; that Fairbanks, Morse & Co. is a corporation organized under the laws of the State of Illinois; that the appellee is a corporation of the State of Delaware, according to the admission of the answer of Fairbanks, Morse & Co. (29), but this allegation is denied by the answer of the appellant City (23).

Paragraphs II, III, IV, V and VI of the complaint (3-13) are admitted by the answers (22, 23) and (29-30). In the admitted paragraphs of the complaint the material allegations are that the appellee is, and has been for several years, the owner of an electric light and power plant in the

City of Forsyth, Montana, and has been engaged in furnishing electric light and power to the said City and its people (3); that the appellant City published in the Forsyth Independent on the 18th of April, 1940, a notice, copy of which is attached to the complaint and marked "Exhibit A" (3). This notice invited bids for the construction of a municipal light, heat and power plant for the City, the bids to be received on the 25th day of April, 1940, stated that the contract price would be paid solely out of the net earnings of the plant, and that any bids received or accepted would be subject to the approval of the resident taxpayers of the City at an election at which the proposed contract would be submitted. The notice further stated that if the proposed contract was approved by the resident taxpayers a formal contract would be entered into, but that if the contract was disapproved, then the acceptance by the City would be null and void (17-18). The specifications upon which bids were invited contained the provisions set out in paragraphs IV, V, and VI of the complaint (4-12), said provisions being the same as those contained in the notice to bidders as above set forth, and further provided that if the validity of the contract should be questioned by a suit in Court and the contract upon final determination should be held illegal and void, then neither party should be liable for damages thereunder (5).

The specifications further provided that the contractor would not be required to begin work until ten (10) days after litigation, looking towards the ousting of the power company serving the City from its streets had been finally determined in favor of the City; that the City would institute such legal action as might be deemed advisable to have

it declared by a Court of competent jurisdiction that the public service corporation, meaning the appellee herein, had no right to use or occupy the streets with its poles, wires or other instrumentalities, and that it be required to remove all of its equipment therefrom when the proposed plant of the City was ready for operation so that the City should be free of its competition (5-6).

The specifications further provided that the title to the entire plant should remain in the contractor until the purchase price was paid with interest; that the entire plant until it was fully paid for should at all times remain personal property; that the payment of the contract let under the specifications should be made solely out of the net earnings of the light and power plant to be constructed; that any earnings in excess of the amount required to make the payments of principal and interest on the contract should be used to pay for extensions and additions to the plant and to anticipate payments of principal and interest on the contract (7); that the City did not guarantee to pay the contract price absolutely and at all events; that the contract price should in no event be or become a general obligation of the City or create any indebtedness against it or be payable out of taxes or out of its general revenues, but payment therefor would be made solely out of the net earnings of the plant and not otherwise (7-8); that the payments to be made should be in installments of \$1,250.00 out of the net earnings of the plant, beginning on the first day of the sixth month after commencement of operation, and a like sum on the first day of each and every month thereafter until half of the contract price was paid, and \$1,500.00 on the first day of each and every month after

half the contract price was paid until the total price was paid in full. There were in the specifications provisions determining the rate of interest, determining what notice should be given in case of default (9); providing for the issuance of revenue certificates to evidence the payments to be made under the contract; providing that the schedule of rates should not exceed certain specified rates during the life of the contract (10-11); that skilled and common labor for the construction of the plant should be secured in the City of Forsyth so long as a competent supply was available; that the contractor should not be required to commence performance while litigation was pending; that the City would furnish any rights-of-way required over private property; that Fairbanks, Morse & Co. filed a bid in the sum of \$169,969; that the Council of the City accepted the bid, subject to the approval of the taxpaying electors (12); that at an election held on the 25th of May, 1940, the question of approving or disapproving the proposed contract was submitted to the taxpaying electors and that a majority of them approved the proposed contract.

The other allegations of the complaint, that is to say, those contained in paragraphs VII to XV, inclusive, were denied. In paragraph VII it was alleged that the City was without power or authority to make or enter into the proposed contract, and if the contract was entered into and the plant constructed as provided for therein, the City would become a competitor of appellee and take from it many of its customers and patrons to its great irreparable damage and injury (13). In paragraph VIII it was alleged that the City in making and entering into the contract was assuming to exercise power and authority conferred by Chap-

ter 115 of the Laws of Montana of the Year 1937, as amended by Chapter 111 of the Laws of Montana for the year 1939; that the emergency mentioned in Chapter 115, as amended, had ceased to exist and that there had not been since long prior to the month of April, 1940, such a condition or situation as is described and recited in said Chapter 115, and that said Chapter 115, as amended, was not and had not been since long prior to the month of April, 1940, of any force or effect; that if the said emergency still existed the said Chapter 115, as amended, would not confer any power or authority on the appellant City to make or enter into the proposed contract (13-14). In paragraph IX it is alleged that Chapter 115, aforesaid, is unconstitutional and void because the emergency mentioned therein is to be determined by the opinion of the Governor, whereas said question is a judicial question for determination by the Courts (14). In paragraph X it is alleged that the appellee has a franchise by virtue of Section 6645 of the Revised Codes of Montana for 1935 to occupy the streets, alleys and public grounds with its poles and wires, and the right to furnish electric light and power to the City and its inhabitants, and that the action of the City in advertising for bids, holding the election and proposing to enter into the contract cast a cloud upon the title of the appellant to said franchise and its right to furnish electric light and power to the City and its inhabitants (14). In paragraph XI it is alleged that the contract is void for want of mutuality for the reason that it is optional with Fairbanks, Morse & Co. to proceed or not to proceed with the construction of the said plant (14-15). In paragraph XII it is alleged that the provision of the contract with

reference to rates is void because rates must be fixed and prescribed by the Public Service Commission of Montana; that by agreeing that the rate should never be in excess of those provided in the contract, the City perpetrated a fraud on the electors that voted at the election, and if the electors had been informed that said rates might be increased at any time many of them who approved of the contract at the election would have voted against it. That the number of those persons is unknown to appellant, but that appellant alleges that, except for said fraud, the said proposed contract would not have been approved (15). In paragraph XIII it is alleged that the plans and specifications for the plant were prepared by or under the direction of the appellant Fairbanks, Morse & Co., and were so prepared as to prevent any competition in the bidding, the consequence of which was that the only bid presented was the bid of the said Fairbanks, Morse & Co. as was intended by said Company and the City (15). Paragraph XIV alleges that the appellee is, and has been for several years, a large taxpayer upon both real and personal property in the City (16), and that the appellee has no adequate remedy at law (16).

In addition to the denials aforesaid, the appellants allege that the City in making and entering into the contract in question is proceeding under the authority conferred upon it by the statutes of the State of Montana, and the decisions of the Supreme Court, including the statutes referred to in paragraph XIII of the complaint, namely Chapter 115 Laws of 1937, as amended, and claims that under said laws and statutes it has full power and authority to enter into the contract aforesaid, and to establish a

municipal light, heat and power plant (23). The answers further allege that on or about the 15th of October, 1904, one, John E. Edwards, obtained a franchise from the Town of Forsyth, Montana, to construct and maintain an electric light plant in the said Town by virtue of an ordinance numbered 32, which is attached to the answer of the appellant City as "Exhibit A"; in and by which ordinance there was granted to the said John E. Edward, his heirs, executors, administrators and his assigns, for a period of twenty (20) years, the privilege of constructing, maintaining and operating an electric light plant in the said Town of Forsyth; that the ordinance was duly submitted to the resident freeholders and taxpayers of the Town for rejection or approval at an election which was duly called and held, and at said election the ordinance was approved; that the appellant City of Forsyth is the successor of the said Town of Forsyth; that the appellee is the assignee of the said John E. Edwards, by him or by *mesne* conveyances, and that the appellee derived its right to occupy the streets and alleys of the City from said ordinance numbered 32 and not otherwise; that the right to occupy the streets under said ordinance has long since expired and that the appellee at the time of the commencement of this action was occupying the streets and alleys of the City solely during the will and pleasure of the appellant City; a true and correct copy of the ordinance is attached to the answer marked "Exhibit A" (24-25); the answers further allege that on the 26th of September, 1905, John E. Edwards organized a corporation under the name of the Forsyth Electric Light and Power Company for the purpose of generating and furnishing electric light and power for

public and private use in the Town of Forsyth; that the term for which the corporation was organized was twenty (20) years from the 26th of September, 1905, and that thereafter the Forsyth Electric Light and Power Company changed its name to the Forsyth Light and Power Company, and that said last mentioned corporation is the assignor of the appellee herein, and the corporation from which it acquired whatever rights it claims to have in the streets and alleys of the City of Forsyth; that at the time of the attempted transfer of the said franchise to the appellee, the assignor had no rights to transfer, and that the appellee acquired no rights by virtue of any transfer or assignment from John E. Edwards or any of his assignees (25-26).

On the motion for judgment on the pleadings, denials and allegations of the answer, which are well pleaded, must be taken as true. *Beal v. Missouri Pacific Railroad Company*, 61 S. Ct. 418, 312 U. S. 45.

SPECIFICATION OF ERRORS.

I.

The court erred in granting appellee's motion for judgment on the pleadings in its favor for the following reasons:

(a) The allegation in the complaint that the amount in controversy exceeds \$3,000, exclusive of costs, (3) is denied by the answers (23-31), and there is no other allegation either in the complaint or in the answers sustaining the jurisdiction.

(b) The purchase price of the electric light and power plant, namely \$169,969 is not the amount or matter in con-

troversy between the appellants and the appellee, and is not the test of jurisdiction.

(c) The appellee, not having any exclusive franchise, has no legal right to be free of the competition of the appellant City in the production, sale and distribution of electricity for itself and its inhabitants, and, therefore, any loss or damage resulting from such competition is *damnum absque injuria*.

(d) Inasmuch as the appellee has no exclusive franchise no legal or equitable right of the appellee is invaded by the proposal or intention of the City to establish its own electric light plant, and, therefore, the appellee has no standing to maintain this action.

(e) Even if the contract between the appellant City and Fairbanks, Morse & Co. is *ultra vires*, the appellee on the face of the pleadings has no standing to maintain this action because there is no amount in controversy between the appellee and appellants.

II.

The Court erred in holding in granting said motion for judgment on the pleadings that the contract between the City and Fairbanks, Morse & Co. was invalid (71).

III.

The Court erred in holding and in adjudging (65, 71) that the appellee has a valid and existing franchise for the maintenance and operation of its electric plant and system in said City.

IV.

The Court erred in holding in granting said motion for judgment on the pleadings that the construction and operation of the municipal light and power plant according to the terms and provisions of said contract would constitute illegal competition with appellee's electric plant and system.

SUMMARY OF POINTS AND AUTHORITIES.

It was conceded in the Court below that the contract in question does not create an indebtedness, and that the appellee has no exclusive franchise. The argument of the appellants proceeds upon that basis.

I.

The District Court erred in granting appellee's motion for judgment on the pleadings because:

(a) The allegation of the amount requisite to confer jurisdiction is denied by the answers.

McNutt v. General Motors Acceptance Corporation, 298 U. S. 178, 56 S. Ct. 780;

Hague v. Committee for Industrial Organization, 307 U. S. 496, 59 S. Ct. 954, 960;

KVOS Incorporated v. Associated Press, 299 U. S. 269, 57 S. Ct. 197;

Kroger Grocery & Baking Co. v. Lutz, 299 U. S. 300, 57 S. Ct. 215;

Buck v. Gallegher, 307 U. S. 95, 59 S. Ct. 740;

Green v. Tacoma, 57 F. 562;

Reese v. Holm, 31 F. Supp. 435;
 Kurn v. Beaseley, 109 F. (2d) 687;
 S. S. Kresge v. Amsler, 99 F. (2d) 503;
 Colony Coal & Coke Corporation v. Napier, 28 F. Supp.
 143.

(b) The purchase price of the electric light and power plant, namely \$169,969, is not the amount or matter in controversy between the appellants and the appellee and is not the test of jurisdiction.

McNutt v. General Motors Acceptance Corporation, 298 U. S. 178, 56 S. Ct. 780;
 Kroger Grocery & Baking Co. v. Lutz, 299 U. S. 300, 57 S. Ct. 215;
 Gibbs, et al v. Buck, 307 U. S. 66, 59 S. Ct. 725;
 Healy v. Ratta, 292 U. S. 263, 54 S. Ct. 700, 702;
 Glenwood L. & W. Co. v. Mutual etc. Co., 239 U. S. 121, 36 S. Ct. 30;
 S. S. Kresge v. Amsler, 99 F. (2d) 503 (8 Cir.);
 Snively Groves v. Florida Citrus Commission, 23 F. Supp. 600;
 Gavica v. Donough, 93 F. (2d) 173 (9 Cir.);
 Miller v. First Service Corporation, 84 F. (2d) 680;
 Carl Fischer Incorporated v. Shannon, 26 F. Supp. 727 (D. C., Mont.);
 Electro Therapy Products Corporation, Ltd. v. Strong, et al, 84 F. (2d) 766.

(c) The appellee, not having an exclusive franchise, has no legal right to be free of the competition of the appellant City in the production, sale and distribution of electricity for itself and its inhabitants, and, therefore, any loss or

damages resulting from such competition is *damnum absque injuria*.

Larson v. State of South Dakota, 278 U. S. 429, 49 S.

Ct. 196, affirming 215 N. W. 880, 51 S. D. 561;

Tennessee Electric Power Co. v. Tennessee Valley Authority, 306 U. S. 118, 59 S. Ct. 366;

Alabama Power Company v. Ickes, 302 U. S. 464, 58 S.

Ct. 300, affirming 91 F. (2d) 303;

Western Tennessee Power and Light Company v. City of Jackson, 97 F. (2d) 979, affirming 21 F. Supp. 57;

Clark v. City of Los Angeles, 116 Pac. 722, 160 Cal. 30;

Western Public Service Co. v. Minneatre, 99 F. (2d) 844.

(d) Inasmuch as the appellee has no exclusive franchise, no legal or equitable right of the appellee is invaded by the proposal or the intention of the City to establish its own electric light plant, and, therefore, the appellee has no standing to maintain this action.

Tennessee Electric Power Company v. Tennessee Valley Authority, 306 U. S. 118, 59 S. Ct. 366;

Southwestern Gas & Electric Co. v. City of Texarkana, 104 F. (2d) 847, petition for writ of certiorari denied;

60 S. Ct. 110, 308 U. S. 586;

Northwest Light & Power Co. v. Town of Milford, 82 F. (2d) 45;

Alabama Power Co. v. Ickes, 91 F. (2d) 303;

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 Washington Water Power Co. v. City of Coeur d'Alene, 24 F. Supp. 790;
 Colorado Life Co. v. Steele, 99 F. (2d) 535.

(e) Even if the contract between the appellant City and Fairbanks, Morse & Company, is *ultra vires*, the appellee on the face of the pleadings has no standing to maintain this action.

Tennessee Electric Power Co. v. Tennessee Valley Authority, 306 U. S. 118, 59 S. Ct. 366, affirming 21 F. Supp. 947;
 Colorado Life Company v. Steele, 95 F. (2d) 535;
 Wright v. Mutual Life Insurance Company of New York, 19 F. (2d) 117;
 Greenwood County v. Duke Power Company, 81 F. (2d) 986, 987;
 Washington Water Power Company v. The City of Coeur d'Alene, 24 F. Supp. 790;
 Alabama Power Co. v. Ickes, 91 F. (2d) 303;
 Memphis Power & Light Co. v. City of Memphis, 112 S. W. (2d) 817, 172 Tenn. 346;
 Western Public Service Co. v. Miniatare, 99 F. (2d) 844;
 Duke Power Co. v. Greenwood, 91 F. (2d) 665.

(f) The Court erred in holding in granting said motion for judgment on the pleadings that the construction and operation of the municipal light and power plant according to the terms and provisions of said contract would con-

stitute illegal competition with appellee's electric plant and system.

Cases *Supra*, particularly those under 1e.

II.

The Court erred in holding in granting the motion for judgment on the pleadings that the contract between the City and Fairbanks, Morse & Company was invalid. Specifically the Court held that Section 5039.63 of the Revised Codes of Montana for 1935 was exclusive in the sense that a lighting plant could only be erected by the issuance of bonds. Said section is as follows:

"The city or town council has power: To contract an indebtedness on behalf of a city or town, upon the credit thereof, by borrowing money or issuing bonds for the following purposes, to-wit: Erection of * * * lighting plants * * *."

Appellants contend that the statute contains a grant of power and not a limitation of the power of the City; in other words, the statute is permissive and not exclusive.

Lang v. Cavalier, 59 N. D. 75, 228 N. W. 819;

Williams v. Village of Kenyon, 187 Minn. 161, 244 N. W. 558;

Carr v. Fenstermacher, 119 Neb. 172, 228 N. W. 114;

Farmers & Merchants State Bank v. City of Conrad, 100 Mont. 415, 47 Pac. (2d) 853;

Kelly v. Merry, 186 N. E. 425, 262 N. Y. 151;

Milligan v. Miles City, 51 Mont. 374, 153 Pac. 276;

See also Sections 4955, 4958, 5039.1, 5039.7, 5039.4, all of Revised Codes, 1935; Chap. 115, Laws of 1937 of

the State of Montana, as amended by Sec. 10, Chap. 111, Laws of 1939 for other authority.

As to right of a city to acquire a plant on credit payable out of its own earnings, see:

McQuillin on Municipal Corporations, Sec. 366, P. 968,
Vol. I;

44 C. J., P. 66, Sec. 2124;

McQuillin on Municipal Corporations, Sec. 2322;

43 C. J., P. 1338, Sec. 2097;

Farmers & Merchants State Bank v. City of Conrad,
100 Mont. 415, 47 Pac. (2d) 853;

Barnes v. City of Lehi, 74 Utah 321, 279 Pac. 878;

Johnston v. City of Stuart (Ia.), 226 N. W. 164;

City of Bowling Green v. Kirby, 220 Ky. 839, 295 S. W.
1004;

Searle v. Town of Haxtun, 84 Colo. 494, 271 Pac. 629;

Bell v. City of Fayette, 28 S. W. (2d) 356, 325 Mo. 75;

Winston v. Spokane, 12 Wash. 524, 41 Pac. 888;

Shields v. Loveland, 74 Colo. 27, 218 Pac. 913;

Faulkner v. Seattle, 19 Wash. 320, 53 Pac. 365;

Seward v. Bowers, 24 Pac. (2d) 253, 37 N. M. 385;

Kelly v. Merry, 186 N. E. 425, 262 N. Y. 151;

Franklin Trust Co. v. City of Loveland, 3 F. (2d) 114;

Underwood v. Fairbanks, Morse & Co., 185 N. E. 118,
205 Ind. 316;

Ward v. City of Chicago, 173 N. E. 810, 342 Ill. 167;
(Notes in 72 A. L. R. 687 and 96 A. L. R. 1385.)

As to the contract being lacking in mutuality, there is no basis whatever for this holding:

13 C. J., P. 13, Sec. 158, and cases cited.

III.

The Court erred in holding that the appellee has a valid and existing franchise for the maintenance and operation of its electric plant and system in said City (65, 71); said holding being based upon Section 6645 of the *Revised Codes of Montana*. Appellants contend that no franchise is obtainable under said Section without the consent of the City, there being no repealing clause in the statute, and in view of the powers reserved in the Act to the City and its power over the streets of the City as recited in Sections 5039.7, 5039.42, 5074, 5075, 5076, 5077, all of *Revised Codes* 1935.

McQuillin on Municipal Corporations, 2nd Ed., Sec. 1745.

IV.

The Court erred in holding in granting said motion for judgment on the pleadings that the construction and operation of the municipal light and power plant according to the terms and provisions of the contract between the appellant City and the appellee would constitute illegal competition with appellee's electric plant and system.

The contract is legal under the authorities cited under Subdivision II above, and even if it were illegal, the appellee has no standing to maintain the action under the authorities cited under I (e) above.

ARGUMENT.

I.

As to error I (a): *that the District Court had no jurisdiction because the allegation in the complaint that the amount in controversy exceeds \$3,000, exclusive of costs, is denied by the answers and there is no other allegation either in the complaint or in the answers sustaining the jurisdiction.*

It seems unnecessary to elaborate on this proposition.

In *McNutt v. General Motors Acceptance Corporation*, 299 U. S. 178, 56 S. Ct. 780, the Court said:

"As he (meaning the plaintiff) is seeking relief subject to this supervision (namely the supervision of the Court), it follows that he must carry throughout the litigation the burden of showing that he is properly in Court. * * * If his allegations of jurisdictional facts are challenged by his adversary in any appropriate manner, he must support them by competent proof, and where they are so not challenged, the Court may still insist that the jurisdictional facts be established or the case be dismissed, and for that purpose the Court may demand that the party alleging jurisdiction justify his allegation by a preponderance of evidence * * * Here the allegation in the bill of complaint as to jurisdictional amount was traversed by the answer. The Court made no finding upon that issue of fact, and the record contains no evidence to support the allegation of the bill. There was thus no showing that the District Court had jurisdiction, and the bill should have been dismissed upon that ground."

See also the other cases cited under "Summary of Points and Authorities" I (a).

As to error I (b), to-wit:

The purchase price of the electric light and power plant, namely \$169,969, is not the amount or matter in controversy between the appellants and the appellee, is not the test of jurisdiction."

The gravamen of the appellee's complaint is contained in paragraph VII (13) wherein it is alleged:

"If said contract is entered into and said plant or system is constructed as provided in said contract, the said City will become the competitor of plaintiff and take from plaintiff many of its customers and patrons to its great irreparable damage and injury."

What the Appellee claims, therefore, is a right to be free of the competition of the City. If it had an exclusive franchise, the value of the right to be free of competition would be the amount or matter in controversy between the appellee and the appellants, but inasmuch as it has no exclusive franchise, it has no right to be free of competition, and, therefore, suffers no legal loss or damage.

The appellee has no cause of action against the appellants, or either of them, based upon the contract for the construction of the plant and could not recover any judgment against them, or either of them, on that score. The allegation in the complaint of the amount of the contract for the construction of the plant is wholly immaterial. The gist of the appellee's complaint is that the appellant City is proposing to establish its own plant and thereby threatening to destroy the appellee's business as purveyor

of electricity. It does not make any difference what the cost of the plant is or may be. The situation would be the same if there was no cost alleged in the complaint, or if the City was being made a present of the plant.

In *McNutt v. General Motors Acceptance Corporation* there were allegations as to the net worth of the business which it conducted in Indiana, the value of the contracts which it purchased, the aggregate value of the contracts, its aggregate sales, and other allegations concerning its business, but the Court held that they were immaterial. Respecting these allegations the Court said:

"The value or net worth of the business which respondent transacts in Indiana is not involved save to the extent that it may be affected by the statutory regulation. *The object or right to be protected against unconstitutional intervention is the right to be free of that regulation. The value of that right may be measured by the loss, if any, which would follow the enforcement of the rules prescribed.* The particular allegations of respondent's bill as to the extent or value of its business throw no light upon that subject. They failed to set forth any facts showing what, if any, curtailment of business and consequent loss the enforcement of the statute would involve. The bill is thus destitute of any appropriate allegation as to jurisdictional amount save the general allegation that the matter in controversy exceeds \$3,000. That allegation was put in issue, and the record discloses neither finding or evidence to sustain it."

In the case at bar, as the appellee has no right to be free of competition, it can sustain no legal loss by competition, and, therefore, the jurisdictional amount is not involved, nor is any amount involved.

In the case of *Gavica v. Donagh, U. S. Attorney*, (C. C. A. 9th Cir.) 93 F. (2d) 173, it is held:

* * * * *

“(2) Matters in controversy, as used in statute providing the District Court shall have original jurisdiction in all suits in which the matter in controversy exceeds \$3,000, are *the rights which plaintiffs assert and seek to have protected and enforced.*” (Judicial Code, Section 24 (1), 28 U. S. C. A. Section 41 (1).

In the case at bar the right which the appellee asserts and seeks to have protected and enforced is the right to be free of competition. It has no such right. But certainly the matter in controversy is not the amount of the contract for the construction of the electric light plant.

In *Electro Therapy Products Corporation, Ltd. v. Strong, et al.*, 84 F. (2d) 766, the plaintiffs claimed that there was an agreement between them and the defendants that defendants would execute at their request all papers necessary to assign and set over to them the title to certain inventions and letters patent, and that the appellents refused to do so. The bill alleged the matter in controversy exceeded the value of \$3,000, exclusive of interest and costs. The Court held that the matter in controversy is *the right which the plaintiffs assert and seek to have protected and enforced*, namely the right to have the inventions assigned to plaintiffs and to no one else, and that the District Court's jurisdiction is to be tested by the value of that right. *Citing McNutt v. General Motors Acceptance Corporation*, *supra*. There was no proof that the value of the inventions exceeded \$3,000, and the Court held

that the Trial Court's finding that the matter in controversy exceeded \$3,000 had no support in the evidence and that the bill should have been dismissed.

In *Gibbs, et al. v. Buck*, 307 U. S. 66, 59 S. Ct. 725, it is held:

"Where the matter in controversy is the right to conduct and carry on a business, and that business has been prohibited by state statute, the *issue on jurisdiction is the value of the right to conduct the business free from the prohibition set up by the statute.*"

In *Colony Coal & Coke Corporation v. Napier*, 28 F. Supp. 76, it is held:

"In a suit for an injunction the amount involved for the purpose of determining the jurisdiction of the Federal Court *is the value of the right to be protected, or the extent of the injury to be prevented.*"

And in *Snively Groves, Incorporated v. Florida Citrus Commission*, 33 F. Supp. 600, it is held:

"In a suit to enjoin the enforcement of a rule or regulation, the amount in controversy necessary to invoke jurisdiction of a Federal Court *is to be measured by the value of the right to be free of the rule or regulation complained of.*"

In the case of *Carl Fischer, Incorporated v. Shannon*, 26 F. Supp. 727, there was a suit by publishers, authors and composers to enjoin enforcement of a Montana statute regulating the pooling of separate interests in certain copyrighted works. Complainants' evidence, which was confined to the value of the copyrights owned and the cost of preparing a list of pooled copyrighted works required by

statute, but not disclosing the value of the right to carry on the business free of the Montana regulation nor of the amount of loss which would result from compliance with the statute, nor that cost of compliance would not be returned at greater income, was insufficient to establish jurisdictional amount.

In *Colorado Life Company v. Steele*, 95 F. (2d) 535, it is held:

“If, from the nature of the case as stated in the petition, there could not legally be a judgment for the amount necessary for the jurisdiction, jurisdiction cannot attach even though the damages laid in the petition are at a sum larger than the jurisdictional amount.”

In the case at bar the matter in controversy is the claimed right to be free of competition, and as there is no such right as a matter of law, there is no loss or damage.

As to errors I (c), *The appellee not having any exclusive franchise has no legal right to be free of the competition of the appellant City in the production, sale and distribution of electricity for itself and its inhabitants, and therefore, any loss or damage resulting from such competition is damnum absque injuria*”;

I (d) *“Inasmuch as the appellee has no exclusive franchise, no legal or equitable right of the appellee is invaded by the proposal or the intention of the City to establish its own electric light plant, and, therefore, the appellee has no standing to maintain this action”*;

I (e), *“Even if the contract between the appellant City and Fairbanks, Morse & Co. is ultra vires the appellee on the face of the pleadings has no standing to maintain this action”*; and

I (f), "*The Court erred in holding in granting said motion for judgment on the pleadings that the construction and operation of the municipal light and power plant according to the terms and provisions of said contract would constitute illegal competition with appellee's electric plant and system.*"

These errors are so interrelated that they may be considered together:

The case of *Tennessee Electric Power Company v. Tennessee Valley Authority*, 306 U. S. 118, 59 S. Ct. 366, affirming 21 F. Supp. 947, covers all of the propositions involved. The appellants, or most of them, in that case had local franchises, but none of them had an exclusive franchise. They sought to restrain the Tennessee Valley Authority, and other corporations, from generating electricity and water power created or to be created, under the Tennessee Valley Authority, and for other relief, claiming that the plan of the Tennessee Valley Authority contravened the constitution of the United States, and that the acts of the defendants would destroy the business of the plaintiff. The Court said:

"It is clear, therefore, that its acts (that is, the acts of the Tennessee Valley Authority) have resulted, and will result, in the establishment of municipal and co-operative distribution systems competing with those of some, or all, of the appellants in territories which they now serve or reasonably expect to serve by extension of their existing systems, and in direct competition with the appellants' enterprise through the sale of power to industries in the areas now served by them or which they can serve by expansion of their facilities. The appellants assert that this competition will inflict substantial injury upon them. The appellees

admit that such damage will result, but contend that it is not the basis of a cause of action since it is *damnum absque injuria*—a damage not consequent upon the violation of any right recognized by law.”

The appellants invoked the doctrine that one threatened with injury by an agent of a government which, but for statutory authority for its performance, would be a violation of its legal rights may challenge the validity of the statute in a suit against the agent. With respect to this the Court said:

“The principle is without application unless the right invaded is a legal right—one of property, one arising out of contract, one protected against tortious invasion, or one funded on a statute which confers a privilege. The appellants further urge that the Tennessee Valley Authority, by competing with them in the sale of electrical energy, is destroying their property and rights without warrant, since the claimed authorization of its transactions is an unconstitutional statute. The pith of the complaint is the Authority’s competition.”

The appellants further claimed that the franchise to be a public utility was a species of property which was directly taken or injured by the Authority’s competition, and they urged that their local franchises, though non-exclusive, are property which the Authority is destroying by its competition, and since what was being done is justified by a reference to the Tennessee Valley Authority Act, which they claim is unconstitutional, they say they have a standing to challenge its constitutionality. With respect to which the Court said:

"The vice of the position is that neither their charters nor their local franchises involve the grant of a monopoly or render competition illegal. The franchise to exist as a corporation and to function as a public utility in the absence of a specific charter contract on the subject creates no right to be free of competition, and affords the corporation no legal cause of complaint by reason of the state's subsequently authorizing another to enter and operate in the same field. The local franchise, while having elements of property, confer no contractual or property right to be free of competition either from individuals, other public utility corporations, or the state or municipality granting the franchise. The grantor may preclude itself by contract from initiating or permitting such competition, but no such contractual obligation is here asserted."

The appellants further argued that if the invasion of their franchise rights does not give them a standing, they may challenge the constitutionality of the grant of power, the exercise of which results in competition. To which the Court said:

"This is but to say that if the commodity used by a competitor was not lawfully obtained by it, the corporation with which it competes may render it liable in damages or enjoin it from further competition because of the illegal derivation of that which it sells. If the thesis were sound, appellants could enjoin a competing corporation or agency on the ground that its injurious competition is *ultra vires*, that there is a defect in the grant of powers to it, or that the means of competition were acquired by some violation of the constitution. The contention is foreclosed by prior decisions that the damage consequent on competition, otherwise lawful, is in such circumstances *damnum*

absque injuria, and will not support a cause of action or a right to sue." (Citing numerous cases in the foot note.)

In the case of *Alabama Power Company v. Ickes*, 91 F. (2d) 303, it was claimed that the defendants were furnishing loans to the municipalities to enable them to construct municipal light and power plants which would enter into competition with the plaintiff, and they claimed that the statute was unconstitutional. The Court held that whether or not the statute was unconstitutional was immaterial because the plaintiff, having no exclusive franchise, no legal or equitable right of the plaintiff was invaded, and, therefore, they were without standing to challenge the validity of the administrator's acts. The Court said:

"Plaintiff's right to be heard in a judicial tribunal resolves itself to the single question of whether or not there has been an invasion of some legal or equitable right. The mere damage that may arise from the competition of municipalities does not amount to an infringement or impairment of any such right, nor does the mere making of loans and grants by the administrator of public works, *although he may be acting beyond the warrant of law*, amount to an impairment of the legal or equitable rights of the plaintiff."

In *Washington Water Power Company v. City of Coeur d'Alene*, 24 F. Supp. 790, it is held:

"An electric company operating under a non-exclusive franchise has no standing to question the validity of a statute authorizing Federal loans and grants for construction of power plants by municipalities."

If it has no standing to question the validity of such a statute, it follows that it has no standing to question the validity of a contract made by a municipality in Montana to construct a municipal light and power plant. The Court said :

“The validity of the act of Congress no longer remains in question in the case since the decision of the Supreme Court in the case of *Alabama Power Company v. Ickes, Federal Administrator of Public Works, et al*, 302 U. S. 464, 58 S. Ct. 300, 82 L. Ed. 381, where the Court held that *even though the Administrator was without authority to make the proposal loan and grant*, yet a company operating under a non-exclusive franchise had no standing to question the validity of the statute authorizing the loan and grant under the Federal Constitution.”

The case quotes from *Milligan v. Miles City*, 51 Mont. 374, 153 Pac. 276, 278, L. R. A. 1916 C. 395 as follows :

“When a city is engaged in operating a municipal plant under an authority granted by a general law, it acts in a proprietary or business capacity, and in this behalf it stands upon the same footing as a private individual or business corporation similarly situated.”

The decision cites a long list of cases upholding the power of the state and municipality to enter into contracts with the public works administrator on such terms as might be agreed upon, and further said :

“These contracts are simply business agreements that the respective parties have a lawful right to enter into, and which appear to us to be reasonable and free from any constitutional restraint. Complainant, no doubt, feels aggrieved that these governmental agencies are prepared to compete with it in the sale of electrical energy,

but that does not render the contracts here invalid.”
(Citing many cases.)

In *Greenwood County v. Duke Power Company*, 81 F. (2d) 986, 987, the Court, speaking through Judge Parker, said:

“For the reasons heretofore stated the plaintiffs are not entitled to an injunction, but even if the statute were unconstitutional or the action of the Administrator unauthorized, they would not be entitled to the injunction which they seek for the reason that no legal right of theirs is infringed by any of the proposed actions of the County or of the Commissioner of public works. It is thoroughly settled that competition by a County or Municipality violates no right of a Public Service Corporation doing business therein which, as is the case of Plaintiffs here, has no exclusive franchise.”

See also

Colorado Life Company v. Steele, 95 F. (2d) 535;
Wright v. Mutual Life Insurance Company of New York, 19 Fed. (2d) 117.

In *Duke Power Company v. Greenwood*, 91 Fed. (2d) 665, it is held:

“The Federal Public Works Administrator could not be enjoined at instant of power company from making loan and grant of federal funds to county for construction of electric power plant because of resulting competition, even if he was acting without authority; since federal government was not attempting regulation of company’s business, county had right to engage in competing business, and no right of power company was infringed.”

II.

The Court erred in holding in granting said motion for judgment on the pleadings that the contract between the City and Fairbanks, Morse & Company was invalid for the reasons:

(a) That the City could only construct a lighting plant by issuing bonds under the authority conferred by Section 5039.63 of the General Statutes, and

(b) That the contract was lacking in mutuality because of the provision therein that the contractor was not required to begin work until ten (10) days after the final determination of a Court that the appellee had no franchise.

The statute 5039.63 Rev. Code 1935 is as follows:

“The city or town council has power: To contract an *indebtedness* on behalf of the city or town, and upon the credit thereof, by borrowing money or issuing bonds for the following purposes, to-wit: Erection of * * * lighting plants * * *.”

It is our contention that the statute is a grant of power and not a limitation of the means by which the power may be exercised. It applies only where an indebtedness is created. There is no indebtedness created here. There are two grants of power; one to borrow money for lighting plants, the other to issue bonds for lighting plants. Cities have no authority to issue bonds without express authority. *McQuillin on Municipal Corporations*, Section 2437, Revised Volume VI. Hence it was necessary to give authority if the municipality desired to finance waterworks or lighting plants by issuing bonds. This did not preclude the municipality from borrowing money without the issuance of bonds for any

public purpose. There is no provision or restriction in this statute preventing the city from acquiring or obtaining a municipal plant by other means than the issuance of bonds or the borrowing of money. The statute does not say that it shall only acquire a lighting plant by issuing bonds or by borrowing money. It puts no prohibition or limitation upon the authority, and it may provide itself with a lighting plant by any lawful means. It is inconceivable that the legislature should intend that a city must go into debt by borrowing money or issuing bonds for a lighting plant when it can acquire such a plant without becoming indebted, and without issuing bonds, by making the purchase price payable out of the earnings of the plant. That method of acquiring plants is and has been in common use in the United States for many years, and the law books are full of decisions where lighting plants have been acquired by that means, as witness:

- Lang v. City of Cavalier, 59 N. D. 75, 228 N. W. 819;
- Williams v. Village of Kenyon, 187 Minn. 161, 244 N. W. 558;
- Davies v. Village of Madelia, 287 N. W. 1, 205 Minn. 526;
- Carr v. Fenstermacher, 228 N. W. 114, 119 Neb. 172;
- Johnston v. City of Stuart (Ia), 226 N. W. 164;
- City of Bowling Green v. Kirby, 220 Ky. 839, 295 S. W. 1004;
- Searle v. Town of Haxtun, 84 Colo. 494, 271 Pac. 629;
- Bell v. City of Fayette, 28 S. W. (2d) 356, 325 Mo. 75;
- Winston v. Spokane, 12 Wash. 524, 41 Pac. 888;
- Shields v. Loveland, 74 Colo. 27, 218 Pac. 913;
- Faulkner v. Seattle, 19 Wash. 320, 53 Pac. 365;

Seward v. Bowers, 37 N. M. 385, 24 Pac. (2d) 253;
 Kelly v. Merry, 186 N. E. 425, 262 N. Y. 151;
 Franklin Trust Company v. City of Loveland, 3 F. (2d) 114;
 Underwood v. Fairbanks, Morse & Company, 185 N. E. 118, 205 Ind. 316;
 Ward v. Chicago, 173 N. E. 810, 342 Ill. 167;
 See also cases collected in 72 A. L. R. 687, and 96 A. L. R. 1385.

In addition to the powers granted to the city by Section 5039.63, it has the following other powers:

"The city or town is a body politic and corporate with the general powers of a corporation, and the powers specified or necessarily implied in this statute or any special laws heretofore enacted." Section 4955, Revised Codes, 1935.

"Every city and town has perpetual succession, may sue and be sued in all Courts and places and in all proceedings whatsoever, and may have and use a common seal, may purchase, receive, have and take, hold, lease, use and enjoy property of every name and description and dispose of the same for the common benefit, and such other powers as are incidental to municipal corporations not inconsistent with the laws of the United States or of this state." Section 5039.1, Revised Codes, 1935.

"To make and pass all By-laws, ordinances, orders and resolutions not repugnant to the constitution of the United States or of the State of Montana, or of the provisions of this title, necessary for the government or management of the affairs of a city or town, for the execution of the powers vested in the body corporate and for carrying into effect the provisions of this title." Section 5039, Revised Codes, 1935.

"To provide for lighting and cleaning the streets, alleys and avenues." Section 5039.6, Revised Codes, 1935.

"To make any and all contracts necessary to carry into effect the powers granted by this Code, and to provide for the manner of executing the same." Section 5039.62, Revised Codes, 1935.

"The city has authority to build or hire all necessary buildings for the use of the city or town, and to heat and light the same." Section 5039.4, Revised Codes, 1935.

Chapter 115 of the General Laws of Montana for the year 1937, as amended and extended by Section 10, Chapter 111, Laws of 1939, authorizes the construction of projects of any character eligible for loans under the provisions of the acts of Congress, known as "Emergency Relief and Construction Act of 1932," "The National Industrial Recovery Act", and authorizes the city councils to contract for the construction of any project to be paid for solely out of the earnings of such project. (The National Industrial Recovery Act is Chapter 90, Page 195, Volume 48 of the United States Statutes at Large.)

Under these powers, without reference to the provisions of 5039.63, the city has authority to erect a municipal lighting plant. In *Milligan v. Miles City*, 51 Mont. 374, 153 Pac. 276, the Court, after reciting certain of the above provisions, including the provisions of 5039.63 but without special reference to the latter, decided that a city in Montana has the power to install a lighting plant to supply light not only for its public buildings and streets, but also for use by its inhabitants. This is in accord with decisions in other jurisdictions where the city or town had more limited powers. For instance in *State, ex rel Buford v. Pinellas County Power Company*, 87 Fla. 243, 100 So. 504, it is held:

"Power to regulate, improve, alter, extend and open streets, to provide for the lighting of the streets of a city or town and to do and perform all such act or acts as should seem necessary and best adapted to the improvement and general interest of the town is sufficient to authorize the municipality to erect and maintain an adequate plant for supplying electric lights and power to the city and its inhabitants." (Citing the following cases: *Dillon on Municipal Corporations*, 5th Ed., Sec. 1302; *Lexington v. Lafayette County Bank*, 165 Mo. 671, 65 S. W. 943; *Gas Company v. Davenport*, 124 La. 22; *Greenville v. Greenville Water Works Company*, 125 Ala. 625; 27 So. 764; *Overall v. Madisonville*, 125 Ky. 684, 102 S. W. 278; *State, ex rel v. Tampa Water Works*, 56 Fla. 858, 47 So. 358, 19 L. R. A., N. S. 183.)

In *Juett v. The Town of Williamstown*, 248 Ky. 235, 58 S. W. (2d) 411, it is held that:

"A city either as an incident to its police power or under statutory authority 'to contract for supplying a city with water and light' may own and operate an electric light plant for the purpose of lighting the public streets and places, and as incidental thereto, may sell the surplus of its product to its inhabitants."

In *Overall v. Madisonville*, 125 Ky. 684, 102 S. W. 278, 281, 12 L. R. A., N. S. 433, it is held:

"Authority to own an electric light plant for the lighting of streets is conferred upon a municipal corporation by statutes empowering it to provide for the lighting of streets, and giving the council control of such works as the city may own for supplying light."

In that case it is further held that a municipal corporation having authority to own a plant for lighting its streets may

sell the surplus of its products to its inhabitants. The Court further said:

"The public lighting of the streets of cities is of modern origin, yet the necessity for lights in a city is scarcely less now than its necessity for water * * *. It is found that light is not only essential to the safety of travelers to prevent their coming in contact with obstructions, but it performs a most valuable office in preventing crime. It is known that crime thrives best in darkness. A good light is the equivalent of a good policeman in preventing certain forms of crime. It is, therefore, universally held now that it is clearly within the police powers of cities, even without express authority, to provide public lighting of their streets at the public expense." (Citing *Crawfordsville v. Braden*, 130 Ind. 149, 14 L. R. A. 268, 28 N. E. 849; *Mauldin v. Greenville*, 33 S. C. 1, 8 L. R. A. 291, 11 S. E. 4; *Ellinwood v. Reedsburg*, 91 Wis. 131, 64 N. W. 885; *Heilbron v. Cuthbert*, 96 Ga. 312, 93 S. E. 206.)

"Where a city is given the power either expressly or by necessary implication as an incident to its police power to light its streets, and where the precise method is not expressly provided, it may either hire another to furnish the lights, or may furnish its own lights. The power to do the thing unreservedly gives the city discretion and the choice of means it will adopt." (Citing *Mauldin v. Greenville*, *supra*; *Smith's Modern Law of Municipal Corporations*, Sec. 881; *Henderson v. Young*, 119 Ky. 224, 83 S. W. 583; *Jacksonville Electric Light Company v. Jacksonville*, 36 Fla. 229, 30 L. R. A. 540, 18 So. 677; *Smith v. Nashville*, 88 Tenn. 464, 7 L. R. A. 469, 12 S. W. 924; *Bridgeport v. Housatonic Railroad*, 15 Conn. 475; *Crawfordsville v. Braden*, 130 Ind. 149, 28 N. E. 849.)

In the *Crawfordsville case*, supra, it is said:

“So far as lighting the streets, alleys and public places of a municipal corporation is concerned, we think that, independently of any statutory power, the municipal authorities have inherent power to provide for lighting them. * * *. We see no good reason why they may not also, without statutory authority, provide and maintain the necessary plant to generate and supply the electricity required. Possessing authority to do the lighting that power carries with it incidentally the further power to procure or furnish whatever is necessary for the production and dissemination of the light * * *. The corporation possessing, as it does, the power to generate and distribute throughout its limits the electricity for the lighting of its streets and other public places, we can see no good reason why it may not also at the same time furnish it to the inhabitants to light their residences and places of business. To do so is in our opinion a legitimate exercise of the police power for the preservation of property and health.”

See also *Swann v. Murray*, 146 Ky. 148, 142 S. W. 244, *McQuillin on Municipal Corporations*, Sec. 1927.

In establishing, owning and operating a lighting plant, the city is exercising proprietary functions.

In *State v. Great Falls*, 139 Mont. 518, quoting from *Illinois Trust & Savings Bank v. City of Arkansas*, 76 Fed. 271, 22 C. C. A. 171, the Court said:

“A city has two classes of powers; the one legislative, public governmental, in the exercise of which it is a sovereignty and governs its people; the other proprietary, quasi private conferred upon it, not for the purpose of governing its people, but for the private advantage of the inhabitants of the city, and of the city

itself as a legal personality. In the exercise of the powers of the former class, it is governed by the rule here invoked (the rule that the contract there considered was beyond the powers of the city). In their exercise it is ruling its people and is bound to transmit its powers of government to its successive sets of officers unimpaired, but in the exercise of the powers of the latter class it is controlled by no such rule because it is acting and contracting for the private benefit of itself and its inhabitants; *and it may exercise the business powers conferred upon it in the same way and in their exercise is to be governed by the same rules that govern private individuals or corporations.* (Authorities cited.) In contracting for waterworks to supply itself and its inhabitants with water, the city is not exercising its governmental or legislative powers, but its business or proprietary powers. The purpose of such a contract is not to govern its inhabitants but to obtain a private benefit for the city itself and its denizens * * *. The powers granted to this city by the legislature of the State of Kansas to contract for and procure water works are plenary and unlimited save but the duty to exercise them with reasonable discretion; and it is not in the province of the Court to contract or clip the legislative grant."

Under the powers conferred upon the city as above set forth, and the authorities cited, the city has power to establish a municipal light, heat and power plant, and in view of the broad power conferred upon the city to make contracts under Section 5039.62, it follows that it has authority to make the contract in question.

"Authority on the part of a municipal corporation to acquire property includes any usual mode of acquisition not prohibited by law." *43 C. J.*, Page 1337, Sec. 2097.

"In the absence of express restrictions a municipal corporation may purchase property on credit as well as for cash." *43 C. J.*, Page 1338, Section 2097.

In *McQuillin on Municipal Corporations*, Sec. 366, Page 968, Volume I, it is said:

"If power is conferred on a municipal corporation by statute and the law is silent as to the mode of exercising such power, the corporate authorities are necessarily clothed with a reasonable discretion to determine the manner in which such powers shall be exercised; all the reasonable methods of executing such powers are inferred, subject, however, to the limitation that the action must be in good faith and neither arbitrary nor capricious. * * * In the absence of any mode prescribed by law, the council may, in its discretion, exercise its power in any usual or appropriate manner * * *. The municipal corporation may, in its discretion, determine for itself the means and methods of exercising its power."

The power conferred by Section 5039.63 is not the only power under which a lighting plant could be established in the city. Under Section 4958 the city "may purchase, receive and take, hold, lease, use and enjoy property of every name or description"; and "has such other powers as are incident to municipal corporations." Under Section 5039 the city has power "to make and pass all By-laws, ordinances, orders and resolutions * * * necessary for the government or management of the affairs of the city, for the execution of the powers vested in the body corporate and for carrying into effect the provisions of this title." Under Section 5039.7 it has authority "to provide for the lighting of streets," and also under Section 5039.6

and under Section 5039.4 it has authority "to build or hire all necessary buildings for the use of the city and to heat or light the same." No method of exercising these powers is prescribed or limited, and, therefore, the city can exercise them in any usual or customary manner. Conditional sales contracts are in common use and a customary method of acquiring property, and are, therefore, appropriate in this case. *Williams v. Village of Kenyon*, 187 Minn. 161, 244 N. W. 558. The authority conferred by Section 5039.63 is permissive only, and not exclusive. *Lang v. Cavalier*, 59 N. D. 75, 228 N. W. 819; *Williams v. Village of Kenyon*, 187 Minn. 161, 244 N. W. 558; *Carr v. Fenstemacher*, 228 N. W. 114, 119 Neb. 172; *Kelly v. Merry*, 186 N. E. 425, 262 N. Y. 151; *Farmers State Bank v. City of Conrad*, 100 Mont. 415, 47 Pac. (2d) 853.

In the *North Dakota* case the same contention was made as is here made that, because the statute authorizes the issuance of bonds for an electric light plant, that method excluded all others. The Court said:

"Chapter 197 provides that cities may pay for such public utility in the manner therein set forth. Surely the city having the general power to own and operate such a public utility was not by this statute forbidden to acquire such utility by gift. Nor can we believe that it was intended thereby to forbid a city to purchase such a utility for cash if it had funds in its treasury otherwise lawfully available. Likewise, it seems to us that these provisions cannot be said to prohibit a city from creating a fund, such as the contract here in question contemplates, out of which a public utility may be purchased. Though it be conceded that the constitution, sec. 183, *supra*, prescribes and defines the character of the obligations secured solely by

public utility properties which a city may issue and Chapter 197, Laws 1927 prescribes and defines the character of the indebtedness which a city may incur in order to provide a public utility, nevertheless neither the constitutional provision nor the statute above referred to purport to deny cities the right to purchase or erect such utilities where this can be done without incurring any debt or obligation."

In *Williams v. Village of Kenyon* it was also claimed that because statute authorized the issuance of bonds for lighting plants and provided that "no such erection, purchase or lease shall be made without approval by the voters of the Village such as is required by law for the issuance of Village bonds for like objects (and) the proposal so to do and the proposal to issue bonds to raise money therefor may be submitted either separately or as a single question" (Section 1229, General Statutes), there was no authority to erect a lighting plant except by means of a bond issue. The Court denied that contention, saying:

"We think that what has been said above shows that since the power to acquire such a plant is expressly conferred, the means of accomplishing that object is left to the village so long as these are such as are customary and reasonable. It cannot be concluded because of the last quoted sentence of Section 1229 that the only way to acquire a plant is by a bond issue. If the village has the cash or some other property to give in trade or someone should wish to donate a plant, it could not be said that Section 1229 stands in the way."

In the *Minnesota* case the Court said, after reciting that the village had the powers of municipal corporations at

common law and quoting *I McQuillin on Municipal Corporations*, Section 124 to the effect that among the powers of municipal corporations at common law were perpetual succession, to sue and be sued and do all other acts as natural persons may:

“Conditional sales contracts are entered into by natural persons and are in common use. Nothing in the statute so far quoted prohibits the village from using such contracts in dealing with personal property. The contract relates to proprietary powers of the village.”

Cities in Montana have such “other powers as are incident to municipal corporations not inconsistent with the laws of the United States or the state.” We take it that these are the powers of the municipal corporation at common law.

In *Carr v. Fenstemacher*, *supra*, there was a conditional sales contract payable from the receipts of the lighting plant as here, and the plaintiffs contended that the statutory methods of raising funds by means of taxation or by a bond issue excluded every other method, and that consequently the contract of purchase and the conditional sales warrant were void. The Court rejected this contention. The Court said:

“A grant of power to a city may imply a means of exercising it in addition to specific statutory methods, without restriction as to others. In direct language, cities of the class to which Sargent belongs are specifically empowered in a single section of the Charter to purchase, construct, maintain and improve a lighting system. The Section next following provides that the cost of such a utility ‘may’ be defrayed by means of a tax levy, and if insufficient for the purpose, by a bond

issue. The word 'may' in the sense used does not necessarily mean 'shall'. If the city has on hand sufficient available money for that purpose resort to a tax levy or to a bond issue is unnecessary. *Christensen v. City of Fremont*, 45 Neb. 160, 63 N. W. 364. On precedent the power to raise funds for a lighting plant by the methods mentioned in the statute is not exclusive. Contracts beyond the power of a municipality are such that it cannot lawfully enter into for any purpose. *Stickel Lumber Company v. City of Kearney*, 103 Neb. 636, 173 N. W. 595. * * * *The City had power in some form to make the purchase. The method adopted was not specifically prohibited by law and does not seem to be illegal. The power to pay for or improve a lighting utility with available money on hand or with net earnings of the plant is implied by the general grant."*

In *Kelly v. Merry*, supra, there was a taxpayer's action to restrain the carrying out of a conditional sales contract for the purchase of Diesel engines and other equipment for an electric light plant. The contract price of the engines was payable from the revenues of the lighting system in sixty (60) monthly installments, evidenced by pledge orders. The village law, Sec. 128-a, provided that no contract should be made involving an expenditure by the village unless the money therefor had been previously estimated by the Board of Trustees as necessary to be raised during the then fiscal year, or unless a resolution to borrow money on bonds or other obligations of the village had been adopted by the Board of Trustees. The Court said:

"The contract in question is a standard form used by the Diesel engine manufacturers known as the 'net revenue' form. The Courts of several states have had it under consideration. While it, or similar forms of

contract, has been upheld in several states (*Lang v. City of Cavalier*, 59 N. D. 75, 228 N. W. 819; *Mississippi Valley Power Company v. Board of Improvements*, 185 Ark. 76, 46 S. W. (2d) 32; *Barnes v. Lehi City*, 74 Utah 321, 279 Pac. 878). It has been condemned in *Indiana Service Corporation v. Town of Warren*, 180 N. E. 14; *VanEaton v. Town of Sidney*, 211 Ia. 986, 231 N. W. 475, 71 A. L. R. 820; *Hesse v. City of Watertown*, 57 S. D. 325, 232 N. W. 53, and elsewhere on the ground it goes beyond the scope of powers granted to the villages by the laws of those states. Local statutes vary as well as the grounds for judicial decision."

It was claimed by the plaintiffs that the contract involved an illegal expenditure of money because (a) the money had not been previously estimated by the Board of Trustees as necessary to be raised during the then fiscal year; (b) no resolution to borrow money on bonds or other obligations of the village had been adopted by the Board of Trustees, and (c) that the money is not otherwise available or specially provided for in the village law. Village Law, Section 128-a. The Court said:

"These are the only limitations on the powers of villages to make contracts for the expenditure of money for village purposes. *N. Y. Const.*, Article VIII Sec. 10. The establishment and maintenance of a village lighting system is unquestionably a village purpose, and the power to make contracts for the purchase of such equipment on credit necessarily follows in the absence of a prohibition. *Ketchum v. City of Buffalo*, 14 N. Y. 356. The Board of Trustees may do all acts expedient or desirable for the management of the business of the village, including the payment of money out of specific property or revenues (Village Law, Sec. 89, Subdivisions 37, 59, *supra*) so long as they are not

inconsistent with law. Section 128 a, supra, contains nothing inconsistent with the purchase of equipment for a lighting system on credit without recourse to taxation or borrowing if the money is 'otherwise available', and it is otherwise available if it is payable out of specific revenues. * * * It makes no difference what else Village Law, Sec. 128-a, supra, prohibits or permits. If it does not prohibit the village from making this contract, it is ineffectual to check the exercise of judgment by the village board in contracting to make expenditures which the section permits. Village authorities are given power to be exercised according to their own ideas of policy. * * * The village law gives the widest discretion to the village board to make contracts for the expenditure of money for village purposes so long as it does not add to the burdens of taxation or borrow money on the obligations of the village, provided always that money is 'otherwise available' to meet the obligations of the village."

In *Farmers State Bank v. City of Conrad*, 100 Mont. 415, 47 Pac. (2d) 853, the city made a contract with the State Conservation Board similar to the contract here in question, wherein the board agreed with the city to install a pipe line from Lake Frances to the city's reservoir, a distance of about seven miles, in order to furnish the city with water from that source. The city agreed to pay to the Conservation Board the sum of \$86,000 over a period of thirty (30) years at the rate of \$6,000 per year with interest at three percent (3%) per annum, and upon payment of said amount out of gross receipts from the sale of water to the inhabitants, the board agreed to transfer the pipe line to the city. This is a conditional sales contract. The contract was upheld. No question was raised that the

city could not construct or cause to be constructed such a pipe line, except out of a bond issue or by borrowing money. The same provision of the statute, namely 5039.63, which it is claimed in this case prohibits the city from constructing a lighting plant except by a bond issue or by borrowing money, is applicable also to water works.

The case of *Whipps, et al. v. Town of Greybull*, 56 Wyo. 355, 100 Pac. (2d) 805, cited by the District Court in support of its decision, is different in its main feature from the case at bar. There the town had issued revenue bonds payable out of the future earnings of the plant to be constructed. The authority to issue "bonds" was required to be approved by the voters before the issuance. It was argued by the defendants that the word "bonds" meant "obligations payable from general revenues", but the Court held that revenue bonds came equally within the prohibition of the statute. The Court cited certain cases in support of its conclusion, and stated that the greater weight of authority was in favor of the contention of the plaintiff "that where a statute authorizes a city to acquire a lighting plant upon the credit of the city, or by borrowing money or by issuing bonds, such method is exclusive" (66). We emphatically assert that the greater weight of authority is with the contention that, where the statute simply authorizes the issuance of bonds or the borrowing of money for a lighting plant but does not expressly limit the erection of a plant to that method of financing, any other lawful method is permissible as has been shown by the cases hereinabove cited. The *Wyoming Statute* (Section 22-1601) *Revised Codes of Wyoming* for the year 1931, provides:

“In addition to the powers provided by law, each incorporated city or town in the state shall have power first, to make local improvements, for which bonds *may be* issued to the contractor or be sold as hereinafter provided; * * * sixth, to establish, maintain and regulate electric light plants and electric power plants for the purpose of supplying the inhabitants with electric lights and power and to light the streets, highways and public buildings, and to supply power for water works and other municipal owned works and utilities.” (It will be noted that we have quoted from the Revised Codes of Wyoming for the year 1931, which is the latest revision of the statutes.)

The words “may be” are used in the statute quoted the same as in *Lang v. Cavalier*, and in *Carr v. Fenstermacher*, supra, and that the words are not exclusive in meaning but merely permissive has been held in the cases cited. The Wyoming statute goes on to recite a long list of powers which, if the means of financing is exclusive, could only be exercised by bond issues or the borrowing of money. We think the method of financing was intended to be limited to the making of local improvements, such as the construction of roads, pavements, sewers, sidewalks, etc., for which bonds might be issued to the contractor in payment, and not to the construction of revenue producing utilities or instrumentalities. Some of the cases cited in the *Whipps case* and others to the same effect were considered by the Court in the case of *Williams v. City of Kenyon*, 187 Minn. 161, 244 N. W. 558, and were not followed, but a long list of cases were cited contra to which we refer the Court rather than encumber the record by producing them here. The cases were also considered in *Seward v. Bowers*, 24 Pac.

(2d) 253, in the concurring opinion of Justice Sadler, which opinion he wound up by saying:

“So that for clearer-cut holdings sustaining the distinction, (that is whether or not contracts of this character are available for acquiring public utilities or improving them without creating a debt), we are confined to the Courts of California, Missouri and United States Court of Appeals of the Eighth Circuit. Against this line of decisions we find arrayed the Courts of the following jurisdictions, to-wit”: (Citing cases from Washington, Utah, North Dakota, Kentucky, Illinois, Colorado, C. C. A. Seventh Circuit, and North Carolina.)

The cases cited by the Court in the *Whipps* case in support of its conclusions are on the off-side, and the language of some of them does not support the Court's conclusion. For instance, in *VanEaton v. Town of Sidney*, 211 Ia. 986, 231 N. W. 475, 71 A. L. R. 220, the Court says:

“To the end that we may not be misunderstood we are not holding that a bond issue is the only method by which an improvement of this kind may be acquired or built.”

The Court holds that the town had no authority “to pledge the rents, income and profits of the electric light plant to be constructed in the future”. This case is off-set in the same jurisdiction by the case of *Johnston v. City of Stuart*, 226 (Ia.) N. W. 164.

The case of *Interstate Power Company v. Ainsworth*, 125 Neb. 419, 250 N. W. 649, holds that a municipal corporation is not authorized to purchase an electric light and power plant by pledging its future net earnings in payment,

and bases its conclusion principally on the case of *Van Eaton v. Town of Sidney*. The *Ainsworth* case is off-set in Nebraska by the *City of Carr v. Fenstermacher*, 228 N. W. 114, 119 Neb. 172.

The case of *Hesse v. City of Watertown*, 357 S. D. 325, 232 N. W. 53, had many features different from the case at bar, and turned on the question whether the bonds in said case were required to be submitted to the voters at an election, and authorized by them, and the decision holds that the bonds proposed to be issued created a debt, which question is not involved in the case at bar.

The case of *Tierney v. Cohen*, 198 N. E. 225, 268 N. Y. 464, is not applicable because the decision in that case was based upon the general city law of the State of New York, providing "that the city shall have no power to issue obligations to which it has not pledged its faith and credit for payment of principal and interest thereof."

In *Lassen Municipal Utility District v. Hopper*, 5 Cal. (2d) 18, 53 Pac. (2d) 347, the question of the authority of the Utility District to issue revenue bonds for a power project was at issue. The Court found that there was no authority under the various Municipal Utility District Acts to issue bonds, principal and interest of which should be payable from the revenue produced by the utility which will be acquired. The Utility District Acts required an election for the issuance of bonds under that act. The right to issue those kind of bonds, however, it appears from the decision, was recognized in the *California Toll Bridge Authority* case, 212 Cal. 298, 298 Pac. 485. In *Shelton v. City of Los Angeles*, 206 Cal. 544, 275 Pac. 421, also the validity of notes issued by a Board of Water and Power Commissioners to secure a loan on occurrence of an emerg-

ency under the Los Angeles City Charter, payable solely out of water revenues of the Board, were held legal.

The case of *State v. McWilliams*, 335 Mo. 816, 74 S. W. (2d) 363, is not applicable. The city proposed to issue revenue bonds but the law under which they were issued required the question to be submitted to and approved by a majority of the voters at a special election. This was not done. The case of *Fairbanks, Morse & Company v. City of Wagoner*, 86 Fed. (2d) 288, is not applicable because a constitutional provision limiting municipal indebtedness provides an exclusive method by which the city might finance the cost of an electric power plant. It confines this to current funds on hand or presently available from lawful tax levies already made, from current earnings or from proceeds of a bond issue authorized in accordance with the constitution.

The case of *Ahern, et al. v. Richardson County*, 256 N. W. 515, 127 Neb. 659, is not applicable. In that case the County Commissioners proposed to issue revenue bonds to construct a bridge. The Court held that in Nebraska Counties are not municipal corporations, and that they have no powers except such as are expressly granted, and there was no statutory authority for the County to issue bonds.

The case at bar is not a taxpayer's suit. While appellee alleges that it is a taxpayer, the allegation is denied, and moreover the action is not brought in a representative capacity as taxpayer. The contract in question is not payable out of taxes. It does not appear that the appellee will be affected in any manner in its property rights by this contract, and will not sustain any legal damages if the

contract be held valid. We do not see, therefore, how it has any right to maintain this action.

As to the other ground of invalidity of the contract claimed to exist because of want of mutuality (66-67), it seems to us there cannot possibly be any basis for a lack of mutuality. It seems to us that the District Court is begging the question (67) when it says, "If the Court is correct in holding that plaintiff has a franchise, then the contractor would not be obliged to construct the plant since the plaintiff could not be ousted as promised by the city and the contract." If the appellee is not ousted then the contract, by its own terms, is at an end. If it is determined that the appellee can be ousted, then the contract is in effect, and the appellant Fairbanks, Morse & Company is obliged to proceed.

The contract here in question is one upon condition.

"The fact that a promise given for a promise is dependent upon a condition does not affect its validity."
13 C. J., Page 330, Sec. 178, and cases cited.

III.

The Court erred in holding and in adjudging that the appellee has a valid and existing franchise for the maintenance and operation of its electric light plant and system in said City.

This determination is based upon Section 6645 of the *Revised Codes of the State of Montana* for the year 1935, which section is as follows:

"A telegraph, telephone, electric light or electric power line corporation or a person owning or operating such

is hereby authorized to install its respective plants and appliances necessary for service, and to supply and distribute electricity for lighting, heating, power and other purposes, and to that end to construct such telegraph, telephone, electric light or electric power line or power lines from point to point along and upon any of the public roads, streets and highways in the State of Montana by the erection of necessary fixtures, including posts, piers and abutments necessary for the wires, but the same shall be so constructed as not to incommode or endanger the public in the use of said roads, streets or highways, *and nothing herein shall be so construed as to restrict the powers of the city or town councils.*"

The section has no clause repealing inconsistent acts or parts of acts.

With respect to streets, Cities of Montana have the following powers:

"To lay out, establish, open, alter, widen, extend, grade, pave or otherwise improve streets, alleys, avenues, sidewalks, parks and public grounds, and vacate the same." Section 5039.5 Revised Codes, 1935.

"And to provide for and regulate street crossings, curbs and gutters, to regulate or prevent the use or obstruction of streets, sidewalks or public grounds by signs, poles, wires, posting hand bills or advertisements or any obstruction." Section 5039.7, Revised Codes, 1935.

"The City or Town Council has power to regulate or suppress the erection of poles and the stringing of wires, rods or cables in the streets, alleys or within the limits of any City or Town." Section 5039.42, Revised Codes, 1935.

"The Council must not grant a franchise or special privilege to any person, save and except in the manner

specified in the next section." Section 5074, Revised Codes, 1935.

"No franchise for any purpose whatsoever shall be granted by any City or Town or by the Mayor or City Council thereof to any person or persons, association or corporation without first submitting the application therefor to the resident freeholders whose names appear on the City or Town tax roll preceding such election." Section 5075, Revised Codes, 1935.

Sections 5076 and 5077 provide for the calling and holding of an election pursuant to the foregoing sections 5074 and 5075, and prescribe the form of the question to be submitted.

These powers are not repealed, but are in fact expressly reserved to the City, and, therefore, Section 6645 does not confer on an electric light or power line the right to occupy the streets in a City without obtaining a franchise or consent therefrom.

Even without the reservation of these powers to the municipality, a public utility cannot use the streets or alleys without the consent of the municipality, unless it is clearly apparent that such was the intention of the legislature. *McQuillin on Municipal Corporations*, 2nd ed., Section 1745, says:

"It is sometimes difficult, however, to determine whether the charter of a company or a statute actually confers authority to use the streets without the consent of the municipality, but statutes granting a franchise to a public utility company including therein a general right to use the streets and alleys of a municipality or municipalities should not be construed as an express grant of the right to use such streets or alleys without the consent of a municipality unless it is clearly apparent that such was the intention of the legislature."

Such intention does not appear in the Section quoted, but on the contrary the intention appears that the powers of the municipality over its streets are reserved to it.

The statute in question does not fix any time for the use of the streets or impose any terms, provisions or conditions on the grantee, and it is well known that franchises do ordinarily contain a provision as to the time during which the franchise shall be exercised, and also other terms, provisions and conditions regulating the use of streets by the utility, none of which is contained in the statute. From which it can be reasonably and fairly inferred that the determination and imposition of such matters was left to the discretion of the municipality. It is inconceivable that a legislature would give *carte blanche* to public utilities to use the streets of the municipalities of the state at their own free will, and without restrictions or regulations of any kind.

The powers of the city expressly reserved to them are not mere police powers; they are powers of control, prevention and prohibition. In *Broad River Company v. South Carolina*, 281 U. S. 537, 548, 50 Sup. Ct. 401, the Court said:

“The very fact that legislative acts of this character are commonly prepared by those interested in the benefits to be derived from them, and that the public interest requires that they should be in such unequivocal form that the legislative mind would be impressed with their character and import, so that the privileges may be intelligently granted or purposely withheld has firmly established the rule that they must be strictly construed, and that any ambiguity or doubt as to their meaning and purpose must be resolved in

favor of the public. (See *Blair v. Chicago*, 201 U. S. 200; *Northwestern Fertilizing Company v. Hyde Park*, 97 U. S. 659, 666.) 'The rule is a wise one which serves to defeat any purpose concealed by the skillful use of terms to accomplish something not apparent on the face of the act, and thus brings about open dealings with legislative bodies.' (*Slidel v. Grandjean*, 111 U. S. 412)."

In the case of *Mitchell v. Dakota Central Telephone Company*, 25 S. D. 409, 127 N. W. 582, it is held that where the consent of the local authorities is required such authorities may impose conditions of consent, and among those may be the limitation of the franchise to a certain number of years, and it may also impose a requirement that the utility pay to the city ten percent (10%) of its gross receipts over and above a specified amount. (Citing a large number of cases.)

In *Town of Seaford v. Eastern Shore Public Service Company*, 21 Del. Ch. 214, 191 Atl. 892, it is held that where the consent of the local governmental agency is required it is in the power of the latter to impose terms and conditions upon which its consent is granted; however onerous they may be, these are matters in the discretion of the responsible local officials.

It appears from the answer in this case that a franchise was originally granted by the Town of Forsyth to John E. Edwards for a period of twenty (20) years. John E. Edwards subsequently organized a corporation which took over the franchise. The duration of the corporate existence of said corporation was twenty (20) years. The appellee succeeded to whatever rights said corporation had, but the franchise originally granted has long since expired.

After the termination of a franchise no right to operate a plant exists unless the municipality does something that would estop it from asserting no such right exists. The fact that the power company was permitted to operate after expiration of the franchise until its contract for street lighting expired gives it no renewal rights. *State, ex rel. v. Arkansas, Missouri Power Company*, 93 S. W. (2d) 887, 339 Mo. 15.

A brief history of Section 6645 will demonstrate that the appellee has no franchise.

Section 14, Article 15, of the Constitution of Montana granted to any person or corporation the right to construct or maintain telegraph and telephone lines within the State, and provided that the legislature should by general law enact reasonable regulations to give full effect to such grant. In conformity therewith the legislature enacted a law which appears as Section 1000 of the Civil Code of Montana for 1895. Said Section provided:

“A telegraph or telephone corporation or a person is hereby authorized to construct such telegraph or telephone line or lines from point to point along and upon any of the public roads by the erection of the necessary fixtures, including posts, piers and abutments necessary for the wires, but the same shall not incommode the public in the use of said roads or highways.”

This act was in strict compliance with the constitutional provision. In 1905 (Chapter 55, Laws of 1905), the legislature amended said Section 1000 so as to provide that telegraph, telephone, *electric light or electric power line corporations* or a person owning or operating such were

authorized to construct their lines upon the public roads and highways of Montana, but contained the clause that:

"The provisions of this act shall not apply to public roads and highways within the limits of incorporated cities or towns."

The act as amended in 1905 did not give electric light and power companies any right to construct their lines within the limits of incorporated cities or towns, nor was there any right from the state prior thereto. On the 10th of September, 1904, John E. Edwards, the appellee's assignor, by *mesne* conveyances, applied for and obtained a franchise from the Town of Forsyth for a period of twenty (20) years. In April 1905, after the passage of the 1905 amendment, one, W. H. Crumb, made a demand on the Mayor and Council of the City of Helena to designate places in and upon the streets of the City for the erection of poles and fixtures *for the installment of a telephone system*. The demand was refused and an alternative writ of mandamus was issued which was quashed in the lower Court. An appeal was taken to the Supreme Court, and it was there contended that inasmuch as the constitution gave telephone companies the right to construct their lines within the state, the law of 1905 limiting the right to construct such lines outside the municipalities was unconstitutional so far as telephone companies were concerned. An examination of that case (*State, ex rel. Crumb v. City of Helena*, 34 Mont. 67) will disclose that there was nothing litigated in that case but the right of the telephone company to use the streets of the City of Helena for its poles and wires without the consent of the city. The Court said:

"The (constitutional) grant was not intended merely to enable telephone and telegraph lines to be constructed and maintained for the purpose of ornamenting railroad lines or public roads in county districts, but to enable the telegraph and telephone business as such to be conducted in this state."

It further stated:

"A statute which provides that a corporation or individual seeking to erect and maintain a line of telephone and engage in the telephone business may erect and maintain such telephone lines along the public roads and highways outside of incorporated cities and towns only, and which leaves the cities and towns free to refuse to enact legislation upon the subject, and thereby prevents such business being conducted within those municipalities, does not give full effect or any practical effect to the grant contained in Section 14, Article 15 above."

It quoted from the case of *State, ex rel. Telephone Company v. Mayor*, 30 Mont. 338, 76 Pac. 758, as follows:

"If the subordinate divisions of the state are vested with the authority of preventing the constructing of these lines (meaning telephone lines), or of imposing restrictions which will have that effect, then the legislature has not complied with the constitutional command."

It will thus be seen that the case concerned telephone companies alone, and that the question of the right of the *electric light and power companies* to construct and operate their lines within municipalities was not in issue. The Supreme Court held that the statute was unconstitutional in so far as it did not permit telephone companies to con-

struct and operate their lines within municipalities, but it did not hold it unconstitutional in so far as electric light and power companies were concerned, and could not well do so; first, because their rights were not in issue, and, second, because such companies have no constitutional authority to construct their lines within the municipalities without getting a franchise from them. The Court did not hold the entire act unconstitutional. It said:

"In so far as the act of 1905 fails to meet the requirement of Section 14, Article 15 of the Constitution it is invalid. It is not necessary to consider in this case whether the whole of the act of 1905 above is inoperative. The proviso is and so far as this appellant is concerned, his rights are the same whether they be measured by the act of 1905 or by Section 1000 of the Civil Code. With the proviso eliminated from the act of 1905, the conditions presented in this case are the same as in the Red Lodge case, and the decision rendered therein is conclusive of this appeal."

In view of the fact that the litigation only concerned the rights of telephone companies the reference to the proviso should be and was intended to be limited to such companies so far as eliminating them from the proviso.

The *Red Lodge case* (*State, ex rel. Telephone Company v. Mayor*, 30 Mont. 338, 76 Pac. 758) was decided in 1904 when the statute that governed the rights of telephone companies was Section 1000 of the Civil Code, which Section gave telegraph and telephone companies authority to construct their lines along and upon any of the public roads of the state, and the rights of telephone companies were all that was determined or intended to be determined

in the *Crumb* case. In the *Helena* case (34 Mont. 67, *supra*), the Court said:

"The question presented for determination here is, 'Does the act of 1905 violate the mandate of the constitution contained in Section 14, Article 15 above?' This section of the constitution is not self-executing. Legislation must be had to make the right granted effective. If the legislature failed or refused to enact any measure on the subject at all, then the right granted would simply lie dormant for it must be conceded that there is not any power which can coerce the legislature into enacting a particular law * * *. In the absence of legislation it would be an unlawful obstruction of any public highway to place poles, posts or other fixtures for the use of telephone or telegraph lines in it * * *. If, however, the legislature does act, the law which it enacts must be a general one of uniform operation, providing reasonable regulations which will give full effect to the grant contained in the section of the constitution quoted above."

It will thus be seen that there was nothing at issue but the right of telephone companies to use the streets of the municipalities for their poles and wires, and the Court held that in view of the constitutional grant the legislation which prevented them from doing so was unconstitutional. The decision, by its very terms, states that in so far as the statute failed to meet the requirements of the constitutional provision it was invalid. That was all that was necessary to the determination of the case, and that was all that was at issue. It was invalid only as respects the rights of telephone companies, leaving the restrictions of the act still applicable to electric light and power companies. We contend that the act remained in force and effect except in so

far as telephone companies were concerned, and that as to those the provision preventing them from using the streets and roads of municipalities without municipal consent was invalid. No question was raised respecting electric light companies.

"A statute may, however, be in part constitutional and in part unconstitutional, and if the parts are wholly independent of each other, that which is constitutional may stand while that which is unconstitutional will be rejected, and this rule applies even though the constitutional and unconstitutional parts are in the same section of the act." 59 C. J. Section 205, page 639; citing among numerous other cases *State v. Courtney*, 71 Pac. 308, 27 Mont. 378.

"In some jurisdictions the Courts apply the principle of severance liberally so as to sustain an act if possible, while in others the doctrine is not favored and is applied with hesitation." 53 C. J., page 642, Sec. 205.

In the foot note it is said:

"The whole tendency, during recent years at least, in this Court has been to apply the principle of severance with increasing liberality." *People v. Mancuso*, 175 N. E. 177, 255 N. Y. 463, 473.

In *Dunn v. City of Great Falls*, 13 Mont. 58, 31 Pac. 1017, the law is stated as follows:

"If when the unconstitutional portion is stricken out, that which remains is complete in itself and capable of being executed in accordance with the apparent legislative intent wholly independent of that which was rejected, it must be sustained." *Hill v. Rae*, 52 Mont. 378, 158 Pac. 826.

In *State, ex rel. District Court*, 56 Mont. 464, 468, 185 Pac. 157, the Court said:

“If it is possible to eliminate the invalid portion (of a statute) without destroying the entire statute, it must be done.” *Hamilton v. The Board*, 54 Mont. 301, 169 Pac. 729.

It can be done in this case.

After the decision in the *Helena case*, Chapter 192, Laws of 1907 was passed amending Section 1000 of the Civil Code of Montana of 1895 as amended by an act of the Ninth Legislative Assembly of Montana, approved March the 2nd, 1905, so as to read as follows, making the act read the same as Section 6645 above quoted, containing the provision:

“Nothing herein shall be so construed as to restrict the powers of city or town councils.”

That provision must be given force and effect. When the unconstitutional part of the act of 1905 is eliminated, the act remains in force as to electric power lines or power line corporations so that they cannot use the streets of municipalities without municipal consent. As hereinbefore stated, there is no repealing clause in the Act of 1907, so that the powers of the City Council over its streets and alleys including the consent of the city required under the 1905 act and the act of 1907 remain in full force and effect, and preclude any electric company from using the streets of the municipality without the consent of the governing body of the city. Therefore, it is fair to conclude that the appellee in this case has no franchise by virtue of Section

6645 to use the streets of the appellant city without its consent, and which consent it has not obtained.

CONCLUSION.

In the operation of public utilities a municipality is governed by the same law as individuals. It is liable for negligence the same as an individual. An individual can make a contract of this kind. Why should not this municipality, acting in its business or proprietary capacity, be permitted to do it? It contravenes no constitution, statute, ordinance or other provision of law. No sound reason of public policy militates against it. Every sound reason of business and economics is in favor of it, for a public utility should be self-supporting. The risk of loss is thrown entirely upon Fairbanks, Morse & Company. If the City realizes earnings sufficient to pay for the plant, the Company gets paid and the City gets the plant. If there are not sufficient earnings, the Company does not get paid. It takes the chances, and the City takes none. If there is an eventual default all the Company can do is to take out part of its plant. It cannot remove the real estate. In the meantime the City has the use and benefit of it. It is conceded that it may pay for it by a bond issue or by taxes. If by a bond issue or by taxes, it is increasing the burden of taxation for itself and its citizens, and takes all the risks. If it can pay for it out of earnings, it takes no risks and it lightens the burden of all taxpayers. Besides the City and its inhabitants can take pride in having a civic enterprise of this kind, owned by the municipality. The appellee will not sustain any loss or damage if an injunc-

tion is denied. Its taxes will not be increased. If it loses its business in the City, it is *damnum absque injuria*, and that is a loss which everyone must take the chances of from competition. There are no equities whatever in the favor of the appellee. All of the equities are in favor of the City. The City is merely exercising its business powers, which are common to individuals in the same line of business. Its inherent powers with respect to this utility authorize it to do all such acts as natural persons may. In order to compete it must have the same right and freedom of contract as individuals or corporations. The voters of the City have authorized the execution of the contract in question, and the establishment of a light plant in the way provided for therein. Moreover it is inconceivable why any person be he taxpayer or otherwise should demand that the equipment should be made payable out of taxes instead of out of its own earnings.

In *Swanson v. City of Ottumwa*, 118 Ia. 161, 189, 91 N. W. 1048, it is said:

“The right of a city to construct and own works of public utilities, if such right exists, is one of great importance and should not be embarrassed or rendered nugatory by strained or technical construction of the constitution or of the statutes. Its importance is not so much in the fact that public ownership is in itself wise or desirable (concerning which there may be much difference of opinion) as in the fact that with

such power in reserve municipalities are placed in positions to deal with private owners on equal terms and avoid exactions which their helplessness might otherwise invite."

The decision should be reversed and the case dismissed.

Respectfully submitted,

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United States Circuit Court of Appeals
FOR THE NINTH CIRCUIT

CITY OF FORSYTH, a municipal corporation of the State of
Montana, and FAIRBANKS, MORSE & COMPANY, a corpora-
tion,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY, a corporation,

Appellee.

REPLY BRIEF.

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SUBJECT INDEX.

	Page
Jurisdictional Question	1-3
Appellee's Cases Considered	1-3
The Franchise Question	4-8
Discussion of Claims of Appellee	4-8
Appellee has no right to challenge validity of Con- tract	8-9
Appellee has no right to maintain action as Tax- payer	9
Contract Not Void for Want of Mutuality	10
Refutation of Claim that City is Without Authority to make Contract in Question	11-12
Authority to Make Contract Under Chapter 115, Laws of 1937 as Amended	12-14

TABLE OF CASES AND AUTHORITIES CITED.

	Page
Arkansas Mo. Power Co. vs. City of Kennett, 78 Fed. (2nd) 911	8
Butte vs. Montana Independent Telephone Co., 50 Mont. 574, 148 Pac. 384	4
City of Campbell vs. Arkansas Mo. Power Co., 55 Fed. (2nd) 560	8
Frost vs. Corporation Comm., 278 U. S. 515, 49 Sup. Ct. 235	8
Mississippi & Missouri R. R. Co. vs. Ward, 67 U. S. 485, 17 L. Ed. 311	2, 3
Owensboro vs. Cumberland T. & T. Co., 230 U. S. 58, 38 S. Ct. 988	6

Purcell vs. Sommers, 34 Fed. Supp. 421	2
St. Louis vs. Western Union Telegraph Co., 149 U. S. 465, 469	6
State ex rel Crumb vs. City of Helena, 34 Mont. 67 ..	5
State vs. Murphy, 134 Mo. 548, 562, 31 S. W. 784, 36 L. R. A. 369, 56 Am. St. Rep. 515	6
Tenn. Electric Power Co. vs. Tennessee Valley Au- thority, 306 U. S. 118, 83 L. Ed. 543	8
Town of Seaford vs. Eastern Shore Public Service Co. et al, 2nd Atl. Monthly, to be published	11

TEXT BOOKS AND STATUTES CITED.

	Page
Dobie, Federal Procedure	3
Montana Statutes 1935, Sec. 6645	4
Montana Constitution, Art. 15, Sec. 4	5
Montana Code, 1895, Sec. 1000	5
Montana Laws, 1905, Sec. 5	5
McQuillin, Municipal Corp. Sec. 1750, 2nd ed.	7
Montana Statutes, 1935, Sec. 5039.63	11
29 Delaware Laws, Chapt. 153, Sec. 32, as amended by 39 Delaware Laws, Second Special Session, Chapt. 24, Sec. 41	11
Montana Laws, 1939, Chapt. 111	12
Montana Laws, 1937, Chapt. 115	12, 14
Emergency Relief and Reconstruction Act of 1932 ..	13
National Industrial Recovery Act	13
Vol. 47, U. S. Statutes at Large	13
Vol. 48, U. S. Statutes at Large, Chapt. 90, page 195.	13

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REPLY BRIEF.

JURISDICTION.

On page 11 of appellee's brief the appellee, after citing *Johnson v. City of Pittsburgh*, 106 F. 753, to the effect that the appellants' objections to the jurisdiction in that case are based upon the assumption that:

"The object or purpose of this action is to prevent the city from becoming a competitor of appellee and that the value of the matter in controversy is the loss which appellee would suffer from such competition"

the appellee herein says:

"This argument completely overlooks the fact that the main purpose of appellee is to protect its franchise

and property by judicial determination that it has a valid franchise and a right to maintain and operate its electric plant or system.”

Nowhere is it alleged what the value of this franchise is, assuming appellee has one, nor what the value of the right to maintain and operate its electric plant or system is, if these were the criteria of jurisdiction, which we deny.

We have examined the cases cited by appellee on the question of jurisdiction (4-12), and find that these cases have no applicability to the case at bar. They relate to entirely different facts and situations. They are mostly old cases—some of them taxpayers’ actions—and have to a large extent been impliedly overruled or discredited. Compare them with the numerous, recent, pertinent cases cited by the appellants on pages 11 to 16 of their brief.

Among the cases cited by appellee is *Mississippi & Missouri Railroad Co. v. Ward*, 67 U. S. 485, 17 L. Ed. 311, concerning which, and other cases not specifically mentioned, Judge Lumpkin, in an elaborate and well considered opinion, in *Purcell v. Sommers*, 34 F. Supp. 421, says:

“In injunction proceedings and in proceedings of a mixed nature similar to this proceeding, it becomes necessary to determine whether the required jurisdictional amount in controversy is present, but certain well established principles have now become imbedded in our law which must be followed in seeking the answer to that question, and these established principles are two in number. First, the right which the plaintiff seeks to protect is the matter in controversy. Second, the right which it is sought to protect must be a right of property, and it must be such that it has a value which can be proved and calculated in the ordinary mode of a business transaction.

"The Courts have reached that determination only through laborious process, *and in effect they have had to overrule certain earlier cases, and particularly what is frequently spoken of as the leading case of Mississippi & M. R. Co. v. Ward*, 2 Black 485, 492, 17 L. Ed. 311. In that case a bill was filed praying for an abatement of a bridge across the Mississippi River, averring it to be a public nuisance especially injurious to the plaintiff as an owner and navigator of steamboats. The Court, through Justice Catron, gave expression to the following frequently quoted sentence with which it disposed of the question of jurisdiction, 'but the want of a sufficient amount of damage having been sustained to give the Federal Courts jurisdiction, will not defeat the remedy as the removal of the obstruction is the matter in controversy, and the value of the object must govern'. Thus the Court did not give effect to what Judge Dobie, in his very excellent book on Federal Procedure, terms, 'The Plaintiff View-Point Rule'. See Dobie on Federal Procedure, page 133, et seq. From the plaintiff's view-point the right which he was seeking to establish was the right to navigate the river unencumbered by the obstruction, and that was the right in controversy.

"It is believed that subsequent and more recent decisions have, however, established the principle that the matter in dispute is the right the plaintiff seeks to protect."

The right which the appellee seeks to protect in this case is the claimed right to be free of competition by the City, but it has no such right.

AS TO THE FRANCHISE.

On page 12 appellee says:

“It follows from this concession that if appellee has a franchise it cannot be ‘ousted’, or in other words, required to remove its poles and wires from the streets, and therefore the other questions presented in the brief for appellants are immaterial, and the judgment of the District Court must be affirmed.”

First, as to the use of the word “concession”, we do not think we have made any concession when we merely stated what is plainly set out in the specifications. These specifications (11-12) provide that if there be any litigation questioning the validity of the contract, “the contractor shall not be required to proceed with the performance thereof until such litigation is finally determined in favor of the owner”. Second, there is a jurisdictional bridge to cross before the Court can determine if appellee has a franchise. If this Court should hold that the District Court was without jurisdiction, then it follows that it has no jurisdiction to determine the merits and must order the dismissal of the bill of complaint. Of course the mere ownership of a non-inclusive franchise does not prevent the City from installing its own plant.

Appellee cites the case of *Butte v. Montana Independent Telephone Co.*, 50 Mont. 574, 148 Pac. 384, as authority for the claim that the powers reserved to city and town councils in Section 6645 of the Montana Statutes are only police powers. We do not think that case determines the question at issue here. The case was one where the City of Butte had passed an ordinance requiring all corpora-

tions maintaining wires within the city for the transmission of electricity to place their wires under ground. The constitution of the State (Article 15, Section 14) gave telegraph and telephone companies the right to construct and maintain lines within the State and connect the same with other lines. In pursuance of the constitutional right accorded to telephone companies the legislature passed an act providing that such companies could construct their lines upon the public roads and highways of Montana without exception. (Section 1000, Civic Code of Montana, 1895.) Subsequently, in 1905 the legislature amended Section 1000 to include electric light and electric power corporations, but provided that the act should not apply to public roads and highways within the limits of incorporated cities or towns. The Supreme Court held (*State, ex rel Crumb v. City of Helena*, 34 Mont. 67) that in so far as the Act of 1905 failed to meet the requirements of the constitution, it was invalid. Thereafter the act was further amended by providing that nothing contained therein should be construed as to restrict the powers of city or town councils. Notwithstanding the constitutional and statutory grant, the Court held that the city had power to regulate and so to order the telephone wires under ground. In the telephone case all the powers the city could have, in view of the telephone company's right to occupy the streets, were powers to regulate. As respects electric light and power companies, the powers of the city were in no wise so restricted. These powers are set out on pages 51 and 52 of appellants' brief.

Appellee contends on page 28 of the brief that the powers of the city with respect to electric light and power

companies are mere police powers and claims that a franchise is not granted in the exercise of the police power. Whether you call the power to regulate a police power or not, it has been held in *Owensboro v. Cumberland T. & T. Co.*, 230 U. S. 58, 38 S. Ct. 988, that,

“Authority of a municipality ‘to regulate the streets and alleys’ gives a power in Connecticut to grant a franchise to a telephone company to place and maintain its poles and wires upon the city streets.”

Mr. Justice Brewer in *St. Louis v. Western Union Telegraph Co.*, 149 U. S. 465, 469, says that power to regulate includes the power to grant franchises, saying:

“Charter power ‘to regulate the use of streets’ is very comprehensive. The word ‘regulate’ is one of broad import. It may be likened to the comprehensive power conferred upon the Congress by the Federal Constitution relating to Foreign and Interstate Commerce. The Federal Courts have always held this power to be broad and comprehensive.”

And, in *State v. Murphy*, 134 Mo. 548, 562, 31 S. W. 784, 34 L. R. A. 369, 56 Am. St. 515, the Court said:

“Under its general powers to regulate the use of streets, the city has authority to authorize corporations and persons for the purpose of serving the public to string telegraph, telephone or electric light wires upon poles above the surface or through conduits beneath the surface of the streets, provided such structures and mechanical appliances do not materially interfere with the ordinary use of the streets, and public travel thereon.”

See generally McQuillin, *Municipal Corporations*, Section 1750, 2d. Ed.

As pointed out in our main brief, there is no repealing clause in Section 6645, and consequently the powers of cities and towns remain intact and in full force and effect. We think the various acts passed by the legislature manifest a policy to protect cities and towns in Montana from being invaded by electric light or power line corporations without permission of the local authorities. When the original act relating to telephone companies was amended in 1905 to include electric light and power companies, or persons owning or operating such, it contained the provision that the act shall not apply to public roads and highways within the limits of incorporated cities or towns, and when the act was further amended as Section 6645, containing the provision that, "Nothing herein shall be so construed as to restrict the powers of city or town councils", the legislature further manifested a policy to reserve to the local authorities the power of controlling their streets as respects their use by electric light and power companies.

"Constitutional provisions or statutes prohibiting the use of the streets of a municipality without the consent of a municipality are to be construed as if they expressly authorized the municipality to grant the use of its streets to such companies." McQuillin, *Municipal Corporations*, Section 1750.

It cannot reasonably be concluded, in the absence of a clear declaration on the subject, that the legislature would commit such an act of folly or be so oblivious to public rights as to place the cities and towns of Montana at the

free use of electric light and power line companies, and, in the absence of such declaration, the consent of the municipality to the occupation of its streets must be obtained, and in the manner prescribed by the municipal law.

AS TO THE CLAIMED RIGHT OF APPELLEE TO CHALLENGE VALIDITY OF CONTRACT.

Under this heading the appellee cites the cases of *City of Campbell v. Arkansas-Missouri Power Company*, 55 F. (2d) 560, and *Arkansas-Missouri Power Company v. City of Kennett*, 78 F. (2d) 911. We think those cases, even if they had any general recognition as authority, have been overruled by the long list of recent cases cited by us under the general heading of "Summary of Points and Authorities", subdivisions (c), (d) and (e), and by the quotations from said authorities on pages 24 to 29 of our main brief.

It is difficult to see how any jurisdictional amount was involved in the Campbell and Arkansas-Missouri Power Company cases inasmuch as there was no exclusive franchise and they could show no damages. It is not enough for the plaintiffs in those cases to show that there was some technical violation of their claimed rights, but there should be a showing, in order to give the Federal Court jurisdiction, that the matter in controversy exceeded \$3,000 in value.

The case of *Frost v. Corporation Commission*, 278 U. S. 515, 49 S. Ct. 235 was considered by the Court in the case of *Tennessee Electric Power Co. v. Tennessee Valley Authority*, 306 U. S. 118, 83 L. Ed. 543 and was not considered applicable. *Tennessee Electric Power Co. v. Tennessee*

Valley Authority is on all fours with the case at bar. In the *Tennessee Valley Authority* case it was claimed that the act under which the Tennessee Valley Authority operated was unconstitutional, and that its acts were *ultra vires*. In the case at bar the appellee is claiming that the city is acting *ultra vires* in attempting to establish a municipal light plant, and in the method of financing it. In the cases cited in our brief the Courts have held that where a company is operating under a non-exclusive franchise, no legal or equitable right is violated, and that it has no standing to maintain the action. It cannot show any legal damages, and, therefore, in the Federal Courts cannot bring itself within their jurisdiction. The only basis upon which the *Frost* case can be reconciled with the case of *Tennessee Valley Authority v. Ickes* and other cases is by considering the *Frost* case as one where the right or franchise was exclusive as against anyone who had not obtained a permit.

APPELLEE HAS NO RIGHT TO MAINTAIN THIS ACTION AS A TAXPAYER.

Appellee has no right to maintain this action as a taxpayer for the following reasons:

(1) The action is not brought in a representative capacity, that is to say, it is not brought for the benefit of the appellee as a taxpayer, and of all other taxpayers (16).

(2) Causes of action in different capacities cannot be united in the same complaint. The appellee cannot join in one action its claims of a private nature and claims to vindicate public rights of taxpayers.

(3) The allegation that appellee is a taxpayer is denied.

(4) There is no allegation in the complaint as to how a taxpayer is damaged, or to what extent, by the action of the city; that is to say, there is no allegation of a jurisdictional amount with respect to a taxpayer's action.

(5) The contract in question is not payable out of taxes, but solely out of the revenues to be derived from the operation of the lighting plant to be installed; so no taxpayer is affected.

(6) There is no finding that appellee is a taxpayer.

THE CONTRACT IS NOT VOID FOR WANT OF MUTUALITY.

We think this point has been adequately met in our brief in chief. The appellants are held to the performance of their contract if the litigation as to the rights of the appellee in the streets of the city is determined in favor of the city. This is a contract on condition. If the contract is void as the appellee claims, it is not damaged in the amount of \$3,000 or any amount.

THE CLAIM THAT THE CITY OF FORSYTH IS WITHOUT AUTHORITY TO MAKE THE CONTRACT IN QUESTION.

The decisions on this question have been thoroughly canvassed on both sides in the briefs already furnished. We contend that the weight of authority is to the effect that the city has a right to make this contract.

The decisions in favor of the validity of the contract are re-inforced by a very recent decision (January 5, 1942) of the Supreme Court of the State of Delaware in the case of *Town of Seaford v. Eastern Shore Public Service Company, et al.* This case has not yet been published but will be soon published in the next issue of the advanced sheets of the Second Atlantic Monthly. We have obtained an advance copy of the decision. In that case part of the syllabus is as follows:

“Under the charter of the Town of Seaford authorizing the council to borrow money and issue bonds or certificates of indebtedness to provide funds for the erection, extension, enlargement or repair of any electric power plant, the method of acquisition of a plant as thus set out is not exclusive on question of validity of purchase of plant under a contract providing that purchase price should be paid only out of revenues derived from operation of plant and distribution system. 29 Del. Laws, C. 153, Sec. 32, as amended by 39 Del. Laws, 2d Sp. Sess., C. 25, Sec. 4.”

In the decision an act entitled “An Act Authorizing the council of the town of Seaford to borrow money and issue bonds to secure the payment thereof for the purpose of providing electric lights for the Town of Seaford” was considered. This act is almost identical with the Montana Statute 5039.63. The Delaware Court, with respect to the act of that State, says:

“We shall pause but slightly to consider this act. The town did not borrow money and did not issue bonds pursuant to the act, and to that extent the quoted act has no bearing on the present question. *We think, however, that the quoted act is a plain legislative recognition of the power of the town to own and*

operate an electric light plant for public lighting and of furnishing light for private use."

Another act amending the charter of the Town of Seaford provided :

"The council may borrow money and issue bonds or certificates of indebtedness to secure the payment thereof on the faith and credit of the Town of Seaford to provide funds for the erection * * * of any plant * * * for the supply or the manufacture and distribution of electricity or gas for light, heat or power purposes * * *"

The act provides for the approval of the electors for the borrowing of any money, and points out in meticulous detail the steps that must be taken to obtain the approval of the electors. The Court then stated that *the act was a clear legislative recognition of the right of the town to have an electric light plant.* The defendant in that case contended that the town had no power to acquire the light plant in any other manner than that set out in the last above referred to act. With respect to which, the Court said :

"It is our opinion that the method of acquisition of an electric plant as set out in the charter is not an exclusive method."

THE AUTHORITY OF CHAPTER 115, LAWS OF 1937, AS AMENDED BY CHAPTER 111 OF THE LAWS OF 1939.

By Section 10, Chapter 111, Laws of 1939, the authority conferred by the above act, as amended, does not expire until March 15, 1941, and it provides that any projects

undertaken prior to that date may be completed thereunder. The project in question was undertaken in April, 1940.

This act, as amended, authorizes the construction of any other projects of any character eligible for loans under the provisions of the act of Congress known as "Emergency Relief and Reconstruction Act of 1932", known also as "The National Industrial Recovery Act", and any other acts amendatory of or supplemental to such acts. The act also authorizes city councils to contract for the construction of any project to be paid for solely from the earnings of such a project, and without liability on the part of the governmental subdivision or agency contracting for the construction of the same. Sec. 3, "Emergency Relief and Reconstruction Act of 1932" provides for making loans or contracts with municipalities and financing projects authorized under Federal, State or municipal law, *which are self-liquidating in character*. Section 201, "Emergency Relief and Reconstruction Act of 1932", volume 47 U. S. Statutes at Large, page 709. "The National and Industrial Recovery Act (Chapter 90, page 195, Volume 48 of the United States Statutes at Large) provides for a program of public works. It includes the construction, repair and improvement of public highways and parks, wharves, public buildings *and any publicly owned instrumentalities and facilities*. A municipal light and power plant payable out of its own earnings is a self-liquidating proposition and is a publicly owned instrumentality and facility. Numerous electric light plants have been erected by municipalities which were partially financed under these acts.

Chapter 115, Laws of 1937, does, therefore, provide for the construction of public lighting plants. The Statute, (Chapter 115) provides:

“This act shall not repeal any statute now in force or prevent the exercise of powers as elsewhere in the statutes of this State provided. It shall constitute an additional method of carrying out the powers herein authorized.”

For the reasons in this and in our main brief assigned, we respectfully submit that the decision of the District Court is erroneous, should be reversed, and the case dismissed.

Respectfully submitted,

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THE CITY OF FORSYTH, A municipal corporation
of The State of Montana, and FAIRBANKS,
MORSE & CO., a corporation,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY, a cor-
poration,

Appellee.

Appellee's Brief

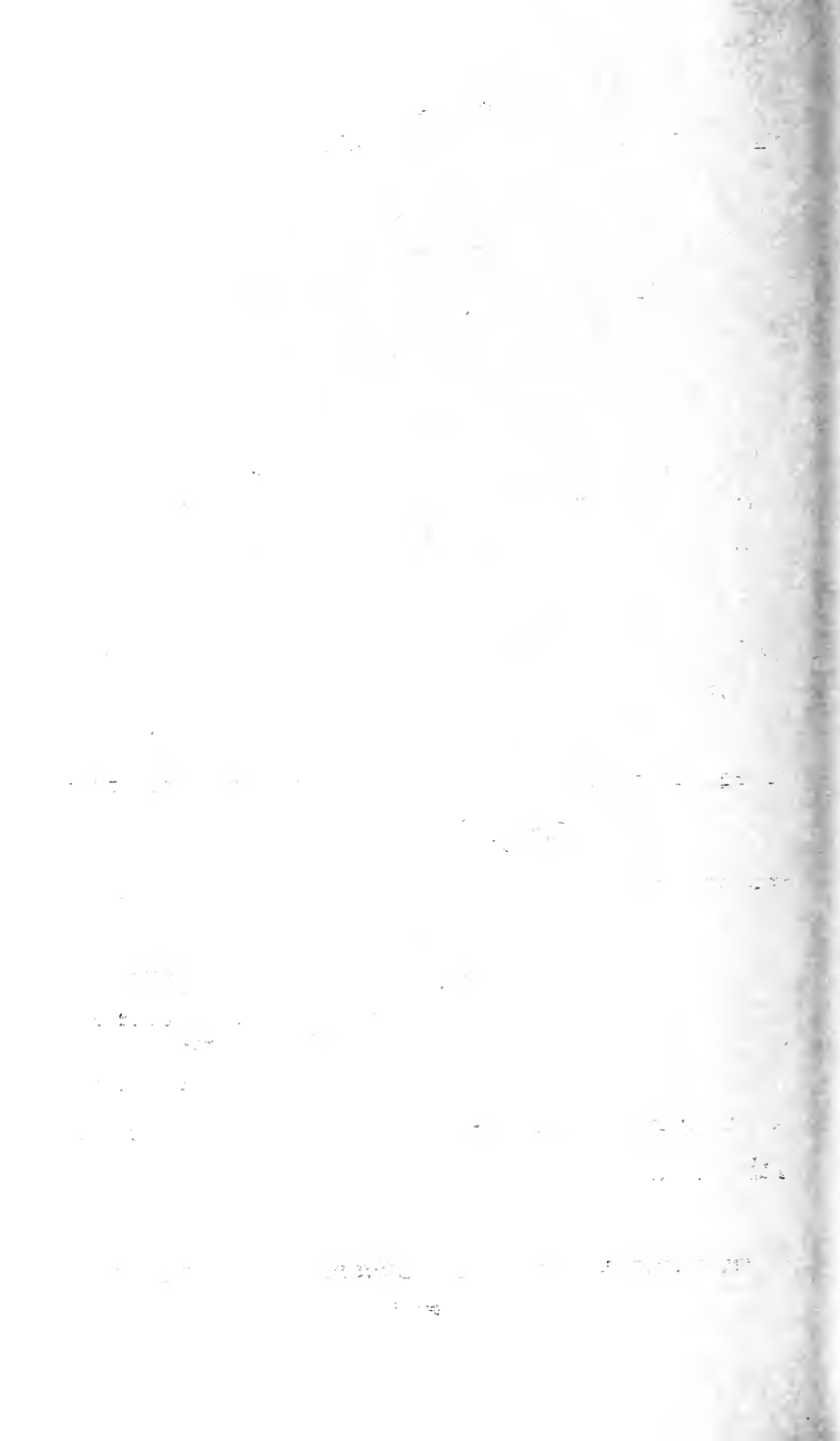
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SUBJECT INDEX

	Page
Appellee's Brief	1
Statement of Pleadings	1
Jurisdiction	4
Appellee Has a Franchise	12
Right of Appellee to Challenge Validity of Contract	29
Right of Appellee to Maintain Action as a Taxpayer	38
Contract Void for Want of Mutuality	40
City of Forsyth Without Authority to Make Such a Contract	42
Chapter 115, Laws of 1937, as Amended in 1939	50

TABLE OF CASES AND AUTHORITIES CITED

	Page
Ahern v. Richardson County, 127 Neb. 659, 256 N. W. 515.....	46
Alabama Power Co. v. Ickes, 302 U. S. 464, 82 L. Ed. 374.....	34
American Smelting & Refining Co. v. Godfrey, 158 Fed. 225....	10
Arkansas-Missouri Power Co. v. City of Kennett, Mo., 78 Fed. (2d) 911	31
Barth v. Ely, 85 Mont. 310, 278 Pac. 1002	52
Butte v. Montana Independent Telephone Co., 50 Mont. 574, 148 Pac. 384	26, 27
Carlson v. City of Helena, 39 Mont. 82, 102 Pac. 39	44
Carr v. Fenstermacher, 119 Neb. 172, 228 N. W. 114	48
City of Butte v. Paltrovich, 30 Mont. 18, 75 Pac. 521	28
City of Campbell, Mo. v. Arkansas-Missouri Power Co., 55 Fed. (2d) 560	29
City of Helena v. Helena Light & Railway Co., 63 Mont. 108, 207 Pac. 337	14, 17
City of Kenosha v. Kenosha Home Tel. Co., 149 Wis. 338, 135 N. W. 848	19, 22
City of Ottumwa v. City Water Supply Company, 119 Fed. 315, 56 C. C. A. 219, 59 L. R. A. 604	8
City of Texarkana v. Southwestern Tel. & Tel. Co., 48 Tex. Civ. App. Rep. 16, 106 S. W. 915	19, 22
Cowell v. City Water Supply Co., 121 Fed. 53	10
Fairbanks, Morse & Co. v. City of Wagoner, 86 Fed. (2d) 288	46
Farmers State Bank v. City of Conrad, 100 Mont. 415, 47 Pac. (2d) 853	49
Frost v. Corporation Commission, 278 U. S. 515, 73 L. Ed. 483	32
Gavica v. Donagh, U. S. Attorney, 93 Fed. (2d) 173	11
Hesse v. City of Watertown, 47 S. D. 325, 232 N. W. 53	46
Illinois Power & Light Corp. v. City of Centralia, 11 Fed. Supp. 874	32
Interstate Power Co. of Neb. v. City of Ainsworth, 125 Neb. 419, 250 N. W. 649	46, 48
Inyo County v. Hess, 53 Cal. App. 415, 200 Pac. 373.....	19
Johnson v. City of Stuart, 226 N. W. (Ia.) 164	48
Johnston v. City of Pittsburg, 106 Fed. 753	10

	Page
Kansas Power Co. v. Fairbanks, Morse & Co., 142 Kan. 109, 45 Pac. (2d) 872	46, 47
Lassen Municipal Utility Dist. v. Hopper, 5 Cal. (2d) 18, 53 Pac. (2d) 347	46
Milligan v. City of Miles City, 51 Mont. 374, 153 Pac. 276	38, 43, 45
Northern Pacific Ry. Co. v. Pacific Coast Lbr. M. Assn., 165 Fed. 1	6, 11
Oklahoma Utilities Co. v. City of Hominy, 2 Fed. Supp. 849....	32
Pearsall v. Great Northern R. Co., 161 U. S. 643, 40 L. Ed. 838	54
Pocatello v. Fidelity & Deposit Co. of Maryland, 267 Fed. 181	41
Postal Telegraph & Cable Co. v. Railroad Commission, 200 Cal. 463, 254 Pac. 258	19
Shapard v. City of Missoula, 49 Mont. 269, 141 Pac. 544	43
State v. City of Great Falls, 110 Mont. 318, 100 Pac. (2d) 915	44
State v. City of Sheboygan, 111 Wis. 23, 86 N. W. 657	19
State ex rel. Billings v. Billings Gas Co., 55 Mont. 102, 173 Pac. 799	18
State ex rel Crumb v. City of Helena, 34 Mont. 67, 85 Pac. 744	15, 17, 25
State v. Dryburgh, 62 Mont. 36, 203 Pac. 508	44
State v. McWilliams, 335 Mo. 816, 74 S. W. (2d) 363	46
State ex rel. Rocky Mountain Bell Tel. Co. v. Mayor of Red Lodge, 30 Mont. 338, 76 Pac. 758	15, 24
Tennessee Elec. Power Co. v. Tennessee Valley Authority, 306 U. S. 118, 83 L. Ed. 543	32-33
Tierney v. Cohen, 268 N. Y. 464, 198 N. E. 225	46
The Miss. & Mo. R. R. Co. v. Ward, 67 U. S. 485, 17 L. Ed. 311	9
Van Eaton v. Town of Sidney, 211 Ia. 986, 231 N. W. 475.....	46, 48
Village of Carthage v. Central New York Tel. & Tel. Co., 185 N. Y. 448, 78 N. E. 165	19
Village of Constantine v. Michigan G. & E. Co., 296 Mich. 719, 296 N. W. 847	19
Wandell v. Johnson, 71 Mont. 73, 227 Pac. 58	42
Washington Market Co. v. Hoffman, 101 U. S. 112, 25 L. Ed. 782	9
Whipps v. Town of Greybull, 56 Wyo. 355, 109 Pac. (2d) 805	46, 47
Wibaux Imp. Co. v. Brietenfeldt, 67 Mont. 206, 215 Pac. 222....	45

TEXTBOOKS AND STATUTES CITED

	Page
Vol. 1 of Foster Federal Practice, 6th Ed., page 50	4
Section 5039.7, Revised Codes of Montana, 1935	27-28
Section 5039.42, Revised Codes of Montana, 1935	27-28
Section 5039.63 Revised Codes of Montana, 1935.....	42, 45, 50, 53
Section 5075 Revised Codes of Montana, 1935	18, 19, 25
Section 6645 Revised Codes of Montana, 1935	12, 17, 18, 19, 25, 26, 28
Section 10520 Revised Codes of Montana, 1935	52
13 Corpus Juris, page 331	41
26 Corpus Juris, page 1024 to 1025, paragraph 41	13
26 Corpus Juris, page 1026	17
43 Corpus Juris, page 285 to 286, paragraph 304	13
59 Corpus Juris, page 1185	54
12 Ruling Case Law, Paragraph 13, page 187	14
Section 12, Article XV of the Montana Constitution	14
Section 14, Article XV of the Montana Constitution	15
Section 1000 of the Civil Codes of 1895	15, 24
Section 1000 of the Civil Codes of 1895, as amended in 1905....	16
Section 940b of the Revised Statutes of Wisconsin of 1898.....	20
Cooley's Constitutional Limitations, 5th Ed., p. 211, et seq.....	25
Section 4800 of the Political Code of 1895	27
Parsons on Contracts, Vol. 1, 9th Ed., page 449	40
Section 27 of Article 10 of Oklahoma Constitution	47
Chapter 115, Laws of 1937	50, 53
Chapter 115 Laws of 1937, as amended by Chapter 111, Laws of 1939	50-51
Chapter 115, Laws of 1937, Section 1	51
Chapter 115, Laws of 1937, Section 10	51
Chapter 111, Laws of Montana of 1939	51, 52

United States
Circuit Court of Appeals
For the Ninth Circuit

THE CITY OF FORSYTH, A municipal corporation
of The State of Montana, and FAIRBANKS,
MORSE & CO., a corporation,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY, a cor-
poration,

Appellee.

Appellee's Brief

STATEMENT OF PLEADINGS

The admitted facts of this case are summarized in the opinion of the District Court (R. p. 61 and in 41 Fed. Supp. 389), and may be briefly stated as follows:

The plaintiff and appellee is and has been for several years the owner of an electric light and power plant or system in the City of Forsyth, consisting, in part, of poles and wires in the streets and alleys of said city, and engaged in furnishing electric light and power to said City and the people of said City at rates prescribed by the Public Service

Commission of Montana, which plant or system was constructed by the predecessor in interest and ownership of the appellee.

The appellant, The City of Forsyth, has entered into a contract with the appellant, Fairbanks, Morse & Co., for the construction of a municipal light, heat and power plant, in accordance with the plans and specifications made a part of said contract, for the consideration of \$169,969.00, to be paid from the earnings of said plant. The plant to remain the property of the contractor, Fairbanks, Morse & Co., until paid for. In the specifications, made a part of said contract, it is provided:

“Completion

The contractor will not be required to begin work until ten days after litigation for the ousting of the power company now serving the city from its streets has been finally determined in favor of the city. The work shall be completed within 180 days after commencement.”

“Removal of Competition

The City undertakes to promptly institute such legal action or proceeding it may deem proper or advisable to have it declared by a judgment of a court of competent jurisdiction that the Public Service Corporation now serving the City and its inhabitants has no right to use or occupy the streets, alleys or public grounds of the City with its poles, wires, or other instrumentalities, and that it be required

to remove all of its equipment therefrom when the proposed plant of the City is ready for production and distribution of electricity so that the City shall be free of its competition.”

In the complaint, paragraph VII (R. p. 13) it is alleged:

“The City is without power or authority to make or enter into said proposed contract and if said contract is entered into and said plant or system is constructed, as provided in said contract, the said City will become a competitor of plaintiff and take from plaintiff many of its customers and patrons, to its great and irreparable damage and injury.”

In paragraph X of the complaint (R. p. 14) it is alleged:

“Plaintiff has a franchise, by virtue of section 6645 of the Revised Codes of Montana of 1935, to occupy the streets, alleys and public grounds of said city with its poles and wires and the right to furnish electric light and power to said city and the inhabitants thereof, as it is now doing, and the action of said City in advertising for bids, holding said election and proposing to enter into said contract casts a cloud upon the title of this plaintiff to said franchise and right to furnish electric light and power, as aforesaid.”

The allegations of paragraphs VII and X are denied by the answers.

The prayer of the complaint is as follows:

“1. That the plaintiff be granted a preliminary injunction enjoining the defendant City from removing the poles and wires of this plaintiff from the streets and alleys of said City or from in any manner interfering with the plant or system of this plaintiff, or the operation of same, and that the said defendants be enjoined from entering into said proposed contract, or, if said contract has been entered into, that said Fairbanks, Morse & Co. be enjoined from constructing such plant or system in accordance with said plans or specifications, or otherwise, and, upon final hearing, said injunction be made permanent.”

JURISDICTION

It is first contended, in behalf of appellants, that the District Court was without jurisdiction for the reason that the amount in controversy does not exceed the sum of \$3000.00, exclusive of interest and costs.

In Volume 1 of Foster Federal Practice, Sixth Edition, page 50, it is said:

“In a suit for an injunction, the value of the matter in dispute is that of the object of the bill, namely, the value, to the plaintiff, of the right for which he prays protection; *or the value, to the defendant, of the acts of which the plaintiff prays prevention;*” (Italics ours).

What is the matter in controversy or dispute in this action?

1. The appellee alleges that it has a franchise granted by the state authorizing the maintenance and operation of its electric plant or system in the City of Forsyth, and the furnishing of electric light and power to said City and the inhabitants thereof. This is denied by appellants. By the contract for the construction of a municipal plant, the City is required to take whatever proceeding is necessary to compel the appellee to remove its poles and wires from the streets and alleys and cease operation of its plant.

The City has entered into a contract with Fairbanks, Morse & Co., for the construction of a municipal plant to cost \$169,969.00, and which plant is to be owned by the City when paid for by the earnings therefrom. It is alleged in the complaint that the City is wholly without authority to enter into such a contract and an injunction is sought to prevent the performance of this contract.

In the brief for appellants, at page 50, it is said:

“If the appellee is not ousted then the contract, by its own terms, is at an end. If it is determined that the appellee can be ousted, then the contract is in effect, and the appellant Fairbanks, Morse & Company is obliged to proceed.”

It thus appears that the value of the matter in controversy is the value to the appellee of its alleged franchise and the value to the appellants of the contract for the construction of a municipal plant, at a cost of \$169,969.00.

In the case of *Northern Pacific Ry. Co. v. Pacific Coast Lbr. M. Assn.*, 165 Fed. 1, decided by the Circuit Court of Appeals for this Circuit, which was an action for an injunction to prevent the Northern Pacific and other railway companies named as defendants from putting into effect certain rates in excess of the then existing rates, the court, in the opinion, at page 11, said:

“Objection is made to the jurisdiction on the ground that it does not appear from the bill that the necessary jurisdictional amount is in controversy. The bill alleges that the matter in controversy ‘exceeds, exclusive of interest and costs, the sum and value of \$2,000.’ In *Wetmore v. Rymer*, 169 U. S. 115, 18 Sup. Ct. 293, 42 L. Ed. 682, it was held that a suit cannot properly be dismissed by a Circuit Court as not involving a controversy of an amount sufficient to come within its jurisdiction unless the facts appear upon the record to create a legal certainty of that conclusion. In *Lee v. Watson*, 1 Wall. 339, 17 L. Ed. 557, it was said:

“By ‘matter in dispute’ is meant the subject of the litigation—the matter for which the suit is brought and upon which issue is joined, and in relation to which jurors are called and witnesses examined.”

The matter in dispute in the present suit is the right of the appellants to enforce a proposed schedule of rates. *Railroad Co. v. Ward*, 2

Black, 485, 17 L. Ed. 311. In principle the case is similar to *Washington Market Co. v. Hoffman*, 101 U. S. 112, 25 L. Ed. 782, a suit in which a number of complainants whose several interests did not equal the jurisdictional amount sought to enjoin the market company from interfering with their right to occupy their respective stalls. The court said:

“The case is one of two hundred and six complainants suing jointly. The decree is a single one in favor of them all and in denial of the right claimed by the company, which is of far greater value than the sum which, by the act of Congress, is the limit below which an appeal is not allowable.”

In *Brown v. Trousdale*, 138 U. S. 389, 11 Sup. Ct. 308, 34 L. Ed. 987, the complainants were taxpayers who sought to restrain the collection of interest and principal on bonds alleged to have been unlawfully issued by the county. The court said:

“The rule applicable to plaintiffs each claiming under a separate and distinct right in respect to a separate and distinct liability and that contested by the adverse party is not applicable here.”

So in *City of Ottumwa v. City Water Supply*, 119 Fed. 315, 56 C. C. A. 219, 59 L. R. A. 604, in a suit by a taxpayer to enjoin the city from issuing bonds, it was held that the power of the city

to issue such bonds is the matter in dispute for the purpose of ascertaining the amount or value in controversy, and not the tax to which the complainant would be subjected. Other cases in point are *Texas & P. Ry. Co. v. Kuteman*, 54 Fed. 548, 4 C. C. A. 503; *American Fisheries v. Lennen*, (C. C.) 118 Fed. 869. But if it is necessary that the bill aver the requisite amount in controversy as to each complainant it is evident from the facts stated that such an averment can be made by amendment, and its absence from the bill is not ground for reversing the injunction order."

In the case of *City of Ottumwa v. City Water Supply Company*, 119 Fed. 315, decided by the Circuit Court of Appeals for the 8th Circuit, which was an action for an injunction to prevent the City of Ottumwa from issuing bonds for the purpose of erecting water works, the court, at page 318, said:

"But the city of Ottumwa was about to enter into the proposed contract for the erection of waterworks, and issue and negotiate bonds of the city as proposed to the amount of \$398,900 to procure money to pay for the same. Complainant contends that the city, being already indebted beyond the constitutional limit, has no right or power to enter into such contract or issue such bonds. Whether it has or has not such power to issue and negotiate that large amount of bonds is certainly the matter in dis-

pute in this suit, brought to restrain and prohibit the city from taking such action.” (Citing several cases.)

In the case of *The Miss. & Mo. R. R. Co. v. Ward*, 67 U. S. 485, 17 L. Ed. 311, which was an action for an injunction for the abatement of a railroad bridge across the Mississippi River as a nuisance, the court said:

“But the want of a sufficient amount of damage having been sustained to give the Federal Courts jurisdiction, will not defeat the remedy, as the removal of the obstruction is the matter of controversy, and the value of the object must govern.”

In the case of *Washington Market Co. v. Hoffman*, 101 U. S. 112, 25 L. Ed. 782, which was an action for injunction to prevent the Washington Market Company from selling a stall in their market occupied by the plaintiff in the case, the plaintiff claiming the right to possession, the court said:

“The first question to be determined is, whether the amount in controversy is sufficient to give us jurisdiction of the appeal. Upon this we have no doubt. * * * * It is averred under oath in the pleadings, that the sale which the Company proposed to make, and the court below enjoined, would have realized to the Market Company more than \$60,000. Of this benefit the decree deprives them. It is very plain, therefore, that the appeal is one within our jurisdiction.”

In the case of American Smelting & Refining Co. v. Godfrey, 158 Fed. 225, which was an action to enjoin the operation of a smelter as a nuisance, the court, in the opinion, at page 229, said:

“But none of these cases can apply here, for the test of jurisdiction is not the amount of damage actually sustained by each of the complainants, but is the value of the object sought by the bill, which in this case is to compel the defendants to cease operating their smelters, or to use such appliances in conducting the work as will effectually protect the complainants from the injuries complained of.”

In the case of Cowell v. City Water Supply Co., 121 Fed. 53, which was a suit for an injunction, decided by the Circuit Court of Appeals for the 8th Circuit, in an opinion by Circuit Judge Sanborn, the court said:

“Perhaps these cases sufficiently illustrate and establish the rule that it is the amount or value of that which the complainant claims to recover, or the sum or value of that which the defendant will lose if the complainant succeeds in his suit, that constitutes the jurisdictional sum or value of the matter in dispute, which tests the jurisdiction of the Circuit Courts of the United States.” (Citing many cases).

See also:

Johnson v. City of Pittsburgh, 106 Fed. 753.

The argument for appellants and the authorities

cited in support of the objection to jurisdiction are upon the assumption that the object or purpose of this action is to prevent the City from becoming a competitor of appellee and that the value of the matter in controversy is the loss which appellee would suffer from such competition. This argument completely overlooks the fact that the main purpose of appellee is to protect its franchise and property by judicial determination that it has a valid franchise and the right to maintain and operate its electric plant or system. If the appellants should prevail, appellee would be required to remove its poles and wires from the streets and alleys of the City of Forsyth.

As said by this Court in the case of *Gavica v. Donagh*, U. S. Attorney, 93 Fed. (2d) 173:

“The matters in controversy are the rights which plaintiffs assert and seek to have protected and enforced.”

We will not undertake to review the authorities cited in the brief for appellants on the question of jurisdiction. They are clearly distinguishable and, as before stated, are presented on the assumption that the object of this action is to prevent the proposed municipal plant from operating in competition with the plant of appellee.

As said by this court in the case of *N. P. Ry. Co. v. Pacific Coast Lbr. M. Assn.*, 165 Fed. 1:

“In *Wetmore v. Rymer*, 169 U. S. 115, 18 Sup. Ct. 293, 42 L. Ed. 682, it was held that a suit can-

not properly be dismissed by a Circuit Court as not involving a controversy of an amount sufficient to come within its jurisdiction unless the facts appear upon the record to create a legal certainty of that conclusion.”

APPELLEE HAS A FRANCHISE

Appellants in their brief (p. 50) say: “If the appellee is not ousted then the contract, by its own terms, is at an end”. If it is determined that the appellee can be ousted, then the contract is in effect and the appellant, Fairbanks, Morse & Co., is obliged to proceed.

It follows from this concession that if appellee has a franchise, it cannot be “ousted” or, in other words, required to remove its poles and wires from the streets and, therefore, the other questions presented in the brief for appellants are immaterial and the judgment of the District Court must be affirmed.

Section 6645 of the Revised Codes of Montana of 1935 provides as follows:

“Rights-of-way for pole lines along streets, roads and highways. A telegraph, telephone, electric light, or electric power line, corporation, or a person owning or operating such, is hereby authorized to install its respective plants and appliances necessary for service, and to supply and distribute electricity for lighting, heating, power, and other purposes, and to that end to construct such telegraph, telephone, electric

light, or electric power line or power lines, from point to point, along and upon any of the public roads, streets, and highways in the State of Montana, by the erection of necessary fixtures, including posts, piers, and abutments necessary for the wires, but the same shall be so constructed as not to incommode or endanger the public in the use of said roads, streets, or highways, and nothing herein shall be so construed as to restrict the powers of city or town councils.”

Except as limited by constitutional restrictions, the power of the legislature to grant public utility franchises in cities and towns in this state is paramount and exclusive. As stated in 26 Corpus Juris, Paragraph 41, pp. 1024 to 1025:

“In the United States the people have succeeded to all the rights and privileges of the Crown, and the legislative department of the government *has exclusive power to grant franchises*, subject, of course, to such constitutional limitations as are applicable.” (Italics ours.)

So, in 43 Corpus Juris, Paragraph 304, pp. 285 to 286, the principle is stated as follows:

“Ordinarily the legislature is the supreme authority in regard to public rights in the streets and highways. And, except as limited in the constitution, it has jurisdiction to grant franchises to be exercised in the streets of the cities and other public highways in the state. * * *

The legislature may enlarge the powers of a

public service corporation, as against the city, except where the constitution provides otherwise. * * * Usually the legislature requires that the street railway companies shall obtain their franchise from the city, although the legislature retains the right of regulation, but in the absence of constitutional restriction these franchises may be conferred by the legislature directly without regard to corporate authority." Citing, with other cases, in support of the text: *Helena v. Helena Light & Ry. Co.*, 63 Mont. 108, 207 Pac. 337.

To the same effect:

12 Ruling Case Law, "Franchises", Paragraph 13, page 187.

The only restriction of legislative authority to grant franchises for the use and occupancy of city streets in this state is that contained in Section 12 of Article XV of the Montana Constitution, which provides that:

"No street or other railroad shall be constructed within any city or town without the consent of the local authorities having control of the street or highway proposed to be occupied by such street or other railroad."

But, as was said in *City of Helena v. Helena Light & Railway Co.*, 63 Mont. 108, (207 Pac. 337) on page 117:

"Section 12 *does not grant any right or power to a city or town.* In the absence of that restric-

tion, the legislature could grant a franchise directly to a street railway company to occupy and use a city's streets, upon such terms as the law makers saw fit to exact, and that, too, *without consulting the city authorities and in utter disregard of their expressed opposition.* The presence of that provision in our Constitution does not modify the principle that the grant of a franchise proceeds from the legislature.” (Italics ours.)

Not only was the legislative authority to grant franchises in city streets in all other cases left unimpaired, but by Section 14 of Article XV of the Constitution, the right of associations and corporations, organized for the purpose of constructing or maintaining lines of telegraph or telephone within the state was expressly granted, and the legislative assembly was required “by general law of uniform operation to provide reasonable regulations to give full effect to this section”.

This constitutional provision was not, as was held in *State ex rel Rocky Mountain Bell Telephone Co. v. Mayor of Red Lodge*, 30 Mont. 338, 76 Pac. 758, and in *State ex rel Crumb v. City of Helena*, 34 Mont. 67, 85 Pac. 744, self-executing, but legislation was required to make the right granted effective. That was done in 1895 by Section 1000 of the Civil Codes of 1895, reading as follows:

“A telegraph or telephone corporation, or a person, is hereby authorized to construct such

telegraph or telephone line or lines from point to point, along and upon any of the public roads, by the erection of necessary fixtures, including posts, piers and abutments, necessary for the wires; *but the same shall not incommode the public in the use of said roads or highways.*" (Italics ours.)

In 1905 Section 1000, above quoted, was amended by including therein: "electric light or electric power-line corporation, or a person owning or operating such," and adding a proviso that the Act shall not apply "to public roads and highways within the limits of incorporated cities or towns". Section 1000 as thus amended reads as follows:

"A telegraph, telephone, electric light or electric power-line corporation, or a person owning or operating such, is hereby authorized to construct such telegraph, telephone, electric light, or electric power line or power lines; from point to point along and upon any of the public roads and highways of the State of Montana, by the erection of necessary fixtures, including posts, piers and abutments necessary for the wires; but the same shall be so constructed as not to incommode or endanger the public in the use of said roads or highways; provided, however, that the provisions of this Act shall not apply to public roads and highways within the limits of incorporated cities or towns."

The proviso in the amendment of 1905 that the

Act “shall not apply to public roads and highways within the limits of incorporated cities or towns” was declared unconstitutional in the case of *State ex rel Crumb v. City of Helena*, 34 Mont. 67, 85 Pac. 744, and this decision prompted the further amendment of the statute by Chapter 192 of the Laws of 1907, page 502, which was carried forward into the Revised Codes of Montana of 1935 as Section 6645, hereinbefore quoted.

The statute, as thus amended, grants to electric light and electric power line corporations the same unconditional right to construct and operate an electric light and power line as is granted to telegraph and telephone corporations.

As was said in *City of Helena v. Helena Light & Railway Co.*, 63 Mont. 108, (207 Pac. 337) on pp. 116 to 117:

“Primarily, the power to grant a franchise rests exclusively in the Legislature, * * * and though it may be doubted whether such power can be delegated, it is recognized generally that a franchise may be derived from the state indirectly, *through the agency* which it may designate for that purpose (citing cases) and whenever a city assumes to grant a franchise, *it acts merely as the agent of the state, and this is true in this jurisdiction*, * * *” (Italics ours.)

As stated in 26 *Corpus Juris*, “Franchises”, at p. 1026:

“The authority by which the power to grant

franchises is conferred can abolish it or take it away. * * * * *

The delegation to an agent of the power to grant franchises *will not prevent the state from making the grant of a franchise directly.*" (Italics ours.)

Appellants contend that, notwithstanding Section 6645 of the Revised Codes of Montana of 1935, appellee is without authority to maintain or operate its electric plant or system without obtaining a franchise from or consent of the City, and, in support of this contention, refers to Section 5075 of the Revised Codes of Montana of 1935, reading as follows:

"No franchise for any purpose whatsoever shall be granted by any city or town, or by the mayor or city council thereof, to any person or persons, association, or corporation, without first submitting the application therefor to the resident freeholders whose names shall appear on the city or county tax-roll preceding such election."

The application of this section is shown by the case of *State ex rel. Billings v. Billings Gas Co.*, 55 Mont. 102, 173 Pac. 799, decided June 24, 1918. That case involved the validity of a franchise granted by the City of Billings to a gas company authorizing the laying of mains and pipes in the streets. The court, in the opinion, said:

"The right granted to the company to use the streets for laying its mains is a franchise."

The court further said:

“A city is prohibited by section 3291, Revised Codes, (now Sec. 5075, Revised Codes of 1935), from granting a franchise *of the character of the one now under consideration*, until the application for it has first been submitted to and approved by the qualified electors, and this statute was in force at the time the franchise in question was granted.” (Italics ours.)

As Section 6645 contains an unconditional grant, Section 5075, above quoted, can apply only to franchises emanating from and granted by municipalities, which they, by delegated authority, are permitted to grant.

State v. City of Sheboygan, 111 Wis. 23, 86 N. W. 657;

City of Kenosha v. Kenosha Home Tel. Co., 149 Wis. 338, 135 N. W. 848;

Inyo County v. Hess, 53 Cal. App. 415, 200 Pac. 373;

Postal Telegraph & Cable Co. v. Railroad Commission, 200 Cal. 463, 254 Pac. 258, 261;

Village of Carthage v. Central New York Tel. & Tel. Co., 185 N. Y. 448, 78 N. E. 165;

City of Texarkana v. Southwestern Tel. & Tel. Co., 48 Tex. Civ. App. Rep. 16, 106 S. W. 915;

Village of Constantine v. Michigan G. & E. Co., 296 Mich. 719, 296 N. W. 847.

In the case of State v. City of Sheboygan, above cited, it appeared that the Wisconsin Telephone

Company, engaged in operating a telephone system in the City of Sheboygan, contemplated the enlargement or extension of its system within the city. The Telephone Company presented to the Mayor and Common Council its proposed plan of enlargement or extension and expressed a willingness to conform to any and all reasonable requirements or changes thought necessary or desirable in its proposed plan. The City refused to approve the plan and an application was made for a writ of mandamus to compel approval. The lower court denied the writ, basing its decision largely on Section 940 (b) of the Revised Statutes of Wisconsin of 1898. In the opinion of the Supreme Court it is said: The Telephone Company's

“authority to use and occupy the streets and highways of the state is granted by section 1778, Rev. St. 1898, which came into existence in 1848. So far as is material to this litigation, such section reads as follows: ‘Any corporation formed under this chapter to build and operate telephones, or conduct the business of telegraphing, may construct and maintain any such lines with all necessary appurtenances, from point to point upon or along or across any public road, highway or bridge or any stream or body of water, or upon the land of any owner consenting thereto, and from time to time extend the same at pleasure; * * * but no such telegraph line or any appurtenance thereto shall at any time ob-

struct or incommode the public use of any road, highway, bridge, stream or body of water’.”

In the opinion it is further said:

“Section 940b, Rev. St. 1898, provides that no franchise shall be granted by any village board or common council until the application therefor, containing the substance of the privileges asked for, shall be filed with the village or city clerk, and be published in the official paper. * * * * As we have already seen, the power to exist as a corporation, and to exercise the franchise of the use of highways and streets, as against the public, was already possessed by the relator. The city had no power to add to or detract therefrom except in the exercise of its police power. The franchise existed by express legislative grant. Its exercise might be controlled only in recognition of its existence, and in conformity with a just and reasonable administration of the police power in the interest of the city and its inhabitants. In a sense, the city was called upon to grant a privilege. It had the power to regulate the use of its streets. It might deem it improper to allow poles to be set along some of the streets included in the proposed extensions. It might designate other streets, and thus exercise a reasonable discretion in the interests of its people. But such privilege was controllable only in harmony with the rights both possessed. In no proper sense was

the privilege sought a franchise, within the meaning of section 940b. The consent of the city was only required or asked in view of its right to regulate. Having that power, it was its plain legal duty, when a plan had been submitted as its ordinance required, to take such action thereon as reason and a proper regard for the interests and legal rights of all concerned would seem to suggest.”

In the later case of *City of Kenosha v. Kenosha Home Telephone Company*, 149 Wis. 338, 135 N. W. 848, above cited, the Supreme Court of Wisconsin said:

“The only franchise needed by a telephone company to enable it to conduct its business anywhere within the state is the franchise conferred upon it by virtue of section 1778, Stats., when it is incorporated pursuant thereto. (Citing many cases). Such franchise confers upon the incorporated telephone company full and adequate authority to construct its lines upon the public highways of the state and the streets of municipalities subject only to reasonable regulations under the police power. (Citing cases). The attempted exercise, therefore, by the city of the legislative function of granting a franchise was ineffectual and void. (Citing cases.)

In the case of *City of Texarkana v. Southwestern Tel. & Tel. Co.*, 48 Texas Civ. App. Rep. 16, 106 S. W. 915, above cited, the court said:

“A solution of the most vexed question presented on the appeal depends upon the construction of the statutes authorizing magnetic telegraph lines to occupy the public roads, streets, etc., in this state on the one hand, and that granting to the city council of incorporated cities and towns the exclusive control and power over streets, alleys, etc., of the city, on the other hand. Article 698, Sayles’ Ann. Civ. St. Tex. 1897, reads: ‘Corporations created for the purpose of constructing and maintaining magnetic telegraph lines are authorized to set their poles, piers, abutments, wires and other fixtures along, upon and across any of the public roads, streets and waters of this state, in such manner as not to incommode the public in the use of such road, streets and waters’.”

The court further said:

“It is a rule of construction too familiar to admit of the citation of authorities that statutes are to be so construed, if possible, as that all parts may stand. It is still another rule, equally as familiar, that repeals by implication are not favored in law. Applying those rules to the present case we have no difficulty in reaching the conclusion that the Legislature did not intend by granting to city councils the exclusive control of streets, alleys, and public grounds within their corporate limits to set at naught the authority previously given by it to telegraph and

telephone lines to occupy such highways with the poles, piers, wires, etc.”

In the case of *State ex rel. Telephone Company v. Mayor*, 30 Mont. 338, 76 Pac. 758, known as the Red Lodge case, the court, referring to Section 1000 of the Civil Code of 1895, said:

“The language of the statute with reference to the privilege granted is plain and emphatic. It is a direct grant of authority by the legislature to use the public roads for the construction and maintenance of telephone and telegraph lines, subject only to the condition that the public shall not be incommoded ‘in the use of said roads and highways’.”

After Section 1000 of the Civil Code of 1895 was amended, by including therein “electric light or electric power-line corporations, or a person owning or operating such” what was said with reference to Section 1000 before the amendment applies equally to the section as amended, which included within its provisions “electric light or electric power-line corporations, or a person owning or operating such”.

If it had been intended that an electric light or electric power-line corporation should not have the right to maintain and operate its line within a city without a franchise from or the consent of the city, the amendment, after the decision in the Red Lodge case, would have retained the proviso in Section 1000 as amended in 1905 to the extent that the same

applied to an electric light or electric power-line corporation or a person owning or operating such a line. Furthermore, if it is necessary for an electric power line corporation to have a franchise from the city, there was no occasion whatever for including such a corporation in Section 1000 as amended.

Section 5075 of the Codes of 1935 was enacted as it now reads in 1903 (Chapter 85 of the Laws of 1903), whereas Section 6645 was enacted in 1907 (Chapter 192 of the Laws of 1907).

In the brief for appellants it is argued (pp. 52, et seq.) that in the case of *State v. City of Helena*, 34 Mont. 67, 85 Pac. 744, the proviso in Section 1000, as amended in 1905, was declared unconstitutional only to the extent that the same applied to telegraph and telephone lines.

Unquestionably, a statute may be unconstitutional in part, or even a section of a statute may contain both constitutional and unconstitutional provisions. Whether, when a part of a statute or a section of a statute is unconstitutional, the question for determination is whether the statute or section would have been enacted without the unconstitutional provision, and this is a question of legislative intent to be determined by the courts.

Cooley's Constitutional Limitations, 5th Edition, p. 211, et seq.

The court, in concluding the opinion in the case of *State v. City of Helena*, 34 Mont. 67, 85 Pac. 744, said:

"With the proviso eliminated from the Act of

1905, the conditions presented in this case are the same as in the *Red Lodge case*, and the decision rendered therein is conclusive of this appeal.” (Italics ours).

This language cannot be construed otherwise than that the court intended to eliminate the proviso as unconstitutional. In any event, this was evidently the construction of the decision by the Legislative Assembly in adopting the amendment of 1907, which did not include the proviso or make any distinction between telephone lines and electric light and power lines. In other words, by the amendatory act of 1907, the same franchise, right or privilege was granted to electric light and power lines as for telegraph and telephone lines and, as a matter of fact, it is wholly immaterial whether the proviso was declared unconstitutional in whole or in part, in view of the amendment.

It is further argued for appellants that as it is provided in Section 6645 that nothing therein should “be so construed as to restrict the power of city or town councils”, there is reserved to cities and towns the right to grant franchises for electric light and power lines.

The answer to this contention is found in the opinion in the case of *Butte v. Montana Independent Telephone Co.*, 50 Mont. 574, 148 Pac. 384, which involved the validity of a city ordinance requiring telephone wires to be placed underground. In the opinion in that case the court said:

“In 1895 the legislature enacted section 4800, Political Code (Rev. Codes, sec. 3259), which provides, among other things: ‘The city or town council has power: * * * 8. To provide for and regulate street crossings, curbs and gutters; to regulate and prevent the use or obstruction of streets, sidewalks and public grounds, by signs, poles, wires, posting hand bills or advertisements, or any obstruction. * * * 43. To regulate or suppress the erection of poles and the stringing of wires, rods or cables in the streets, alleys, or within the limits of any city or town.’ With knowledge that these statutes were in full force and effect, the legislature in 1907 enacted what is now section 4400, Revised Codes, which defines certain rights of a telegraph, telephone, electric light or electric power line corporation, or a person owning or operating such, and then concludes: ‘Nothing herein shall be so construed as to restrict the powers of city or town councils.’ *By the use of this language the legislature must have intended to leave cities and towns a free hand to exercise the police powers granted in subdivisions 8 and 43 above; otherwise the expression is meaningless.*” (Italics ours.)

The provisions of Section 4800 of the Political Code of 1895, quoted in the foregoing extract from the opinion in the case of *Butte v. Montana Independent Telegraph Co.*, are identical with Sections

5039.7 and 5039.42 of the Montana Codes of 1935.

That the powers conferred by Sections 5039.7 and 5039.42 are police powers is evident from the fact that the powers granted are powers to “regulate”.

City of Butte v. Paltrovich, 30 Mont. 18, 75 Pac. 521.

A franchise is not granted in the exercise of the police power.

It is further argued for appellants that the rule of strict construction should be applied to Section 6645 of the Codes of 1935, hereinbefore quoted, and that “a public utility cannot use the streets or alleys without the consent of the municipality, unless it is clearly apparent that such was the intention of the legislature”. There could be no clearer expression of the intention of the legislature to grant to an electric light and power line corporation a franchise to construct, maintain and operate its line within a city than is contained in Section 6645 of the Revised Codes of 1935.

In the opinion of District Judge Pray, (R. p. 65) it is said:

“Without discussing the question minutely as set forth in the voluminous briefs of counsel, it seems quite clear that plaintiff has a franchise (Sec. 6645, R. C. M. 1935), although one that is not exclusive,”

As appellants concede that if appellee has a franchise their contract “is at an end”, (Appellants’

Brief, p. 50), we respectfully submit that the judgment of the District Court should be affirmed.

**RIGHT OF APPELLEE TO CHALLENGE
VALIDITY OF CONTRACT**

Appellants contend that even though appellee may have a franchise, as it is not an exclusive franchise, appellee cannot challenge the validity of said contract, or the right of the City to acquire the municipal plant to be constructed according to the contract, as any damage which appellee might sustain by the performance of the contract and competition by the City would be *damnum absque injuria*. While we regard this question as unimportant in view of the concession of appellants that if appellee has a franchise, the contract is at an end, we submit that, although the franchise is not exclusive, it constitutes property and appellee is entitled to protection by injunctive relief against illegal competition, and that the competition which would result from the contract in question would be illegal, will be presently shown.

In the case of *City of Campbell, Mo. v. Arkansas-Missouri Power Co.*, 55 Fed. (2d) 560, decided by the Circuit Court of Appeals for the 8th Circuit, and in which Fairbanks, Morse & Co. was a defendant, the court, in the opinion, at page 561, said:

“In this case, appellee as plaintiff brought suit to enjoin the city of Campbell, a Missouri city of the fourth class, its executive officers, and Fairbanks, Morse & Co., a corporation, from

carrying out the provisions of a certain contract which the city had previously entered into with Fairbanks, Morse & Co. for the purchase of certain machinery for a municipal light plant, and to restrain the city from operating such a plant in competition with the appellee, because of the alleged illegality of that contract. The parties will be referred to as they appeared in the lower court.

Plaintiff is an electric power company engaged in the generation of electricity and the transmission of electric current into various municipalities for sale for private and public use. It is the owner of a franchise granting it the right to construct and operate an electric light plant and distribution system within the city of Campbell.”

The court further said (p. 562):

“As the owner of this franchise, however, the plaintiff was entitled to relief against the illegal acts of others who might assume to exercise the privilege conferred upon it by its franchise. A franchise is property, and, as such, is under the protection of the law, and without express words it is exclusive as against all persons acting without legal sanction. True, plaintiff’s franchise was not exclusive in the sense that the city might not grant similar right to another, yet it was exclusive against any one who assumed to exercise the privilege granted the plaintiff,

in the absence of authority or in defiance of law. (Citing many cases).

We are clear that the plaintiff, as the holder of this franchise to maintain and operate the plant in defendant city, was entitled to protection against all illegal competition."

It was decided that the contract between the City of Campbell and Fairbanks, Morse & Co., was void and the judgment of the District Court granting an injunction was affirmed.

The case of Arkansas-Missouri Power Co. v. City of Kennett, Mo., 78 Fed. (2d) 911, decided by the Circuit Court of Appeals for the 8th Circuit, was an action for an injunction to prevent the installation of a municipal plant. The plaintiff was the holder of a non-exclusive franchise. The court, in the opinion by Circuit Judge Sanborn, at page 914, said:

"If it (the city) is proceeding lawfully, the mere fact that the power company's property will be injured or destroyed, resulting in the impairment of the investments of those who furnished money to it in the belief that their investments would not be lost through the unnecessary duplication of the company's plants, is of no legal consequence. On the other hand, if the city is proceeding unlawfully, then the power company may invoke the rule of law which protects the owner of a franchise or permit, although it be nonexclusive, against the illegal acts of others who propose to exercise the privilege conferred by the franchise."

In the case of *Frost v. Corporation Commission*, 278 U. S. 515, 73 L. Ed. 483, the complainant and appellant was the owner of a franchise to operate a cotton ginning plant in the City of Durant, Oklahoma. In the opinion the court said:

“Appellant, having complied with all the provisions of the statute, acquired a right to operate a gin in the city of Durant by valid grant from the state acting through the corporation commission. While the right thus acquired does not preclude the state from making similar valid grants to others, it is, nevertheless, exclusive against any person attempting to operate a gin without obtaining a permit or, what amounts to the same thing, against one who attempts to do so under a void permit; in either of which events the owner may resort to a court of equity to restrain the illegal operation upon the ground that such operation is an injurious invasion of his property rights.”

See also:

Okla. Utilities Co. v. City of Hominy, 2 Fed. Supp. 849;

Illinois Power & Light Corp. v. City of Centralia, 11 Fed. Supp. 874.

Appellants in their brief cite as a controlling authority, in support of the proposition that any damage which appellee might suffer from the construction of the municipal plant would be *damnum absque injuria*, the case of *Tennessee Electric Pow-*

er Co. v. Tennessee Valley Authority, 306 U. S. 118, 83 L. Ed. 543.

The complainants in that case were public utility corporations engaged in generating and selling electricity pursuant to state authority, and the defendants were the Tennessee Valley Authority and its executive officers. In the opinion the court said:

“The Authority’s acts, which the appellants claim give rise to a cause of action, comprise (1) *the sale of electric energy at wholesale to municipalities empowered by state law to maintain and operate their own distribution systems;* (2) *the sale of such energy at wholesale to membership corporations organized under state law to purchase and distribute electricity to their members without profit;* (3) *the sale of firm and secondary power at wholesale to industrial plants.*” (Italics ours.)

The court further said:

“The pith of the complaint is the Authority’s competition.”

It was contended in behalf of T. V. A. and its officers that, as the franchises of appellants were not exclusive, any damages which appellants might suffer from competition resulting from the sale of electricity as proposed by T. V. A. would be *damnum absque injuria*, and for this reason appellants could not challenge the constitutionality of the Tennessee Valley Authority Act. This contention was sustained. The appellants made no claim that the sale

of electricity as proposed would be in violation of any state law.

The court, in discussing the right of the appellants to question the constitutionality of the Act, said:

“The appellants further argue that even if invasion of their franchise rights does not give them standing, they may, by suit, challenge the constitutionality of the statutory grant of power the exercise of which results in competition. This is but to say that if the commodity used by a competitor was not lawfully obtained by it the corporation with which it competes may render it liable in damages or enjoin it from further competition because of the illegal derivation of that which it sells.”

The court, in deciding that the appellants could not question the constitutionality of said Act cited in a foot-note to the opinion in support of its decision the case of *Alabama Power Co. v. Ickes*, 302 U. S. 464, 82 L. Ed. 374. In that case it appeared that Mr. Ickes as Administrator of the Federal Emergency Administration of Public Works had entered into agreements with four municipal corporations in Alabama which contemplated the construction of electricity-distribution systems. The agreements provided for the making of loans to the municipalities and the donation of 45% of the cost of labor and materials used in construction. In the opinion the court said:

“Each of the municipalities is authorized un-

der state law to construct and operate municipal electric plants and distribution systems, and to engage in competition with petitioner.”

It was argued for the complainants that, as a result of the loans and grants and the maintaining of rival and competing plants, the complainants would suffer damage by the loss of business. The court in the opinion further said:

“It, therefore, appears that each of the municipalities in question has authority to construct and operate its proposed plant and distribution system in competition with petitioner, and to borrow money, issue bonds, and receive grants for that purpose; * * * * * In short, the case for petitioner comes down to the contention that consummation of the loan-and-grant agreements should be enjoined on the sole and detached ground that the administrator lacks constitutional and statutory authority to make them, and that the resulting moneys, which the municipalities have clear authority to take, will be used by the municipalities in lawful, albeit destructive, competition with petitioner. * * * * *

The ultimate question which, therefore, emerges is one of great breadth. Can anyone who will suffer injurious consequences from the lawful use of money about to be unlawfully loaned maintain a suit to enjoin the loan?”

This question was answered in the negative and it was decided that any damage complainants might suffer would be *damnum absque injuria*.

In closing the opinion the court said:

“Frost v. Corporation Commission, 278 U. S. 515, 73 L. Ed. 483, 49 S. Ct. 235, relied upon by petitioner, presents an altogether different situation. Appellant there owned a cotton-ginning business in the city of Durant, Oklahoma, for the operation of which he had a license from the corporation commission. The law of Oklahoma provided that no gin should be operated without a license from the commission, which could be obtained only upon specified conditions. We held that such a license was a franchise constituting a property right within the protection of the Fourteenth Amendment; and that while the acquisition of the franchise did not preclude the state from making similar valid grants to others, it was exclusive against an attempt to operate a competing gin without a permit or under a void permit. The Durant Cooperative Gin Company sought to obtain a permit from the commission which, for reasons stated in our opinion, we held would be void and a clear invasion of Frost’s property rights. We concluded that a legal right of Frost to be free from such competition would be invaded by one not having a valid franchise to compete, and sustained Frost’s right to an injunction against the commission and the Durant Company. See Corporation Commission v. Lowe, 281 U. S. 431, 435, 74 L. Ed. 945, 948, 50 S. Ct. 397. The difference

between the Frost Case and this is fundamental; for the competition contemplated there was unlawful while that of the municipalities contemplated here is entirely lawful.”

It is apparent that the Tennessee Electric Power Company case does not and was not intended to overrule the case of Frost v. Corporation Commission.

In all of the other cases cited in support of the proposition that any damages appellee may suffer would be *damnum absque injuria*, the question presented was the same as the question decided in the Alabama Power Company v. Ickes and in the Tennessee Electric Power Company case,—that is the right to challenge the constitutionality of Federal aid.

In the case before the Court no complaint is made of any action by the Federal Government in furnishing money or otherwise, or that such a contract as to Fairbanks, Morse & Co. would be *ultra vires*. We are making no contention that Fairbanks, Morse & Co. is without authority to enter into such a contract. What we are contending is that the state law does not authorize the City of Forsyth to enter into the contract in question or to acquire an electric plant in the manner in which it is proposed, and that the contract is void for want of mutuality. In other words, that the City would be an illegal competitor of appellee by virtue of state law.

A city in Montana in acquiring and operating an

electric light and power plant exercises its business or proprietary powers, as distinguished from its governmental powers, and “stands upon the same footing as a private individual or a business corporation similarly situated”.

Milligan v. City of Miles City, 51 Mont. 374, 384, 153 Pac. 276, 278.

If, as we contend, the City of Forsyth is not authorized to make such a contract, or the contract is lacking in mutuality, it is in the situation of an individual who would undertake, without authority of law, to construct and operate an electric plant in Forsyth in competition with appellee.

Irrespective of appellee's rights by virtue of its franchise, to maintain this action, it has such right as the owner of taxable property in the City of Forsyth.

RIGHT OF APPELLEE TO MAINTAIN ACTION
AS A TAXPAYER.

In the complaint it is alleged that the appellee is the owner of an electric light and power plant and is and has been for several years engaged in furnishing electric light and power to said city and its inhabitants. This allegation is admitted. It follows therefrom that the appellee is a taxpayer in said city.

In the case of Milligan v. City of Miles City, et al., 51 Mont. 374, 153 Pac. 276, the plaintiff, as a taxpayer, sought an injunction to prevent the city from extending its steam electric light and power plant

for the purpose of furnishing steam heat for private consumption, at a cost of \$10,600.00, which would be replaced from revenues derived from the sale of steam. The right of the plaintiff to maintain the action, as a taxpayer, was challenged. The court in the opinion said:

“The plant is their (the taxpayers) property. The revenues derived from the sale of its product belong to them, because, though kept separate from the revenues derived from general taxation, they are part of the public moneys.

The rule is well settled that, in the absence of legislation restricting the right to interfere to some public officer, the courts will, upon the application of one or more of the individual taxpayers, interfere by appropriate process to prevent an unlawful expenditure of public money by the officers of the corporation or the incurring of an obligation which will render such expenditure necessary. There never has been any such restrictive legislation in this jurisdiction, *and from an early date in the history of the state the right of the taxpayer to maintain an action to prevent or restrain misuse of corporate power has been recognized and enforced.* (Citing several Montana cases). The conclusion that the plaintiff may maintain the action was therefore correct.” (Italics ours).

While the allegation of the complaint that the appellee is a taxpayer is denied, the denial is nullified

by the admission of facts which make appellee a taxpayer.

CONTRACT VOID FOR WANT OF MUTUALITY

The contract contains the following provision, to-wit:

“The contractor will not be required to begin work until ten days after litigation for the ousting of the power company now serving the city from its streets has been finally determined in favor of the city. The work shall be completed within 180 days after commencement.”

As Fairbanks, Morse & Co. is not required to begin work until ten days after litigation for the ousting of the plaintiff has been finally determined in favor of the City, it, of course, follows that if it should be determined that the plaintiff has a valid franchise and cannot be ousted, it is optional with Fairbanks, Morse & Co. whether the electric plant will be constructed. In other words, the defendant Fairbanks, Morse & Co. does not obligate itself to construct the plant unless it is finally determined that the plaintiff is without a franchise.

We, therefore, submit the contract is invalid and unenforcible because of want of mutuality.

In Parsons on Contracts, Volume 1, 9th Ed., at page 449, it is said:

“that a promise is not a good consideration for a promise unless there is an absolute mutuality of engagement, so that each party has the

right at once to hold the other to a positive agreement.”

In 13 Corpus Juris, p. 331, it is said:

“Mutuality of contract consists in the obligation on each party to do, or to permit something to be done, in consideration of the act or promise of the other. Contracts lacking in mutuality are often termed unilateral contracts. Mutuality of obligation is an essential element of every enforceable agreement. Mutuality is absent when one only of the contracting parties is bound to perform, and the rights of the parties exist at the option of one only.”

The principle stated by Parsons was applied in the case of *Pocatello v. Fidelity & Deposit Co. of Maryland*, 267 Fed. 181, in an opinion by the Circuit Court of Appeals for the 9th Circuit. In that case, which was an action on the bond of a surety for a contractor who had entered into a contract with the City of Pocatello relating to a municipal water supply for the city, for the recovery of an amount paid by the city in excess of the contract price for doing the work which the contract required to be done. The contract provided that if:

“for any reason the city of Pocatello shall fail to make sale of and receive money for the \$150,000 of waterworks bonds due to be sold on the 8th day of January, 1917, then and in that event this contract, at the option of the party of the second part, may be terminated without the

party of the second part becoming liable in any manner or upon any account to the party of the first part upon any claim or demand whatsoever.”

In the opinion, by Circuit Judge Hunt, it is said:

“The purpose of the city, as made apparent by the language of article 11, was to reserve the right to terminate the contract, provided it did not dispose of its bonds, and in the exercise of such right, to escape any liability to any one upon any claim or demand whatever. A contract of such a nature could not be enforced; it lacks mutuality. There was no performance by either party to the contract and no waiver of lack of mutuality. Parsons on Contracts (9th Ed.) 486.”

In the opinion in the case of *Wandell v. Johnson*, 71 Mont. 73, 227 Pac. 58, the court said:

“Speaking generally, mutuality of obligation is an essential ingredient of an enforceable contract (*Raiche v. Morrison*, 37 Mont. 244, 95 Pac. 1061), and mutuality is lacking, of course, when only one of the contracting parties is bound to perform (6 Cal. Jur. 211; 13 C. J. 331).”

The District Court decided that the contract is void for want of mutuality.

**CITY OF FORSYTH WITHOUT AUTHORITY
TO MAKE SUCH A CONTRACT**

The statute, Section 5039.63 of the Revised Codes of Montana of 1935 provides:

“The city or town council has power: To

contract an indebtedness on behalf of the city or town, and upon the credit thereof, by borrowing money or issuing bonds for the following purposes, to-wit: Erection of * * * lighting plants * * *.”

A “lighting plant” which the city or town is thus authorized to erect, in the manner provided in the Section above quoted, is a lighting plant or system to supply the needs of both the city and its inhabitants.

Milligan v. City of Miles City, 51 Mont. 374, 384, 153 Pac. 276, 278.

It is our contention that the method thus provided for acquiring an electric plant is exclusive and that the city is without authority to acquire such a plant by the issuance of revenue bonds to be paid from the earnings of the plant.

It is the contention of appellants that the statute is a grant of power and not a limitation of the means by which the power may be exercised, and that the city has authority to make such a contract by virtue of its general powers. In other words, that the method provided in the section of the statute quoted for acquiring such a plant is not exclusive.

In the case of Shapard v. City of Missoula, 49 Mont. 269, 278, 141 Pac. 544, 547, it is said:

“The rule is well settled in this jurisdiction and by the decisions generally that a municipal corporation can exercise no powers except those which are granted in express words or those

necessarily implied in or incident to the powers expressly granted, or those indispensable to the objects and purposes of the corporation, and that any reasonable doubt as to the existence of a particular power is to be resolved against the corporation (*Davenport v. Kleinschmidt*, 6 Mont. 502, 13 Pac. 249; *Helena L. & Ry. Co. v. City of Helena*, 47 Mont. 18, 130 Pac. 446), and that, when the mode of exercising any power is pointed out in the statute granting it, the mode thus prescribed must be pursued in all substantial particulars. (*McGillic v. Corby*, 37 Mont. 249, 17 L. R. A. 1263, 95 Pac. 1063; *Carlson v. City of Helena*, 39 Mont. 82, 17 Ann. Cas. 1233, 102 Pac. 39; see, also, *Bolton v. Gilleran*, 105 Cal. 244, 45 Am. St. Rep. 33, 38 Pac. 881; *San Jose Imp. Co. v. Auzerai*, 106 Cal. 498, 39 Pac. 859). The statute having defined the measure of the power granted, and also the mode by which it is to be exercised, the validity of the action of the legislative body of the municipality must be determined by an answer to the inquiry whether it has departed substantially from the mode prescribed."

State v. Dryburgh, 62 Mont. 36, 47, 203 Pac. 508;

Carlson v. City of Helena, 39 Mont. 82, 109, 102 Pac. 39;

State v. City of Great Falls, 110 Mont. 318, 100 Pac. (2d) 915, 920;

Wibaux Imp. Co. v. Brietenfeldt, 67 Mont. 206, 215 Pac. 222.

In the case of Milligan v. City of Miles City, 51 Mont. 374, 383, 153 Pac. 276, 278, the court said:

“It is true, as counsel for the defendants argue, that the powers granted to a municipality are to be distinguished into two classes—the first including those which are legislative, public or governmental, and import sovereignty; the second those which are proprietary or *quasi* private, conferred for the private advantage of the inhabitants and of the city itself as a legal person. (Citing cases.) Nevertheless the statute is the measure of the power granted, whether the particular power in question is assignable to the one class or the other. The inquiry must always be in this class of cases: (1) Whether there is an express grant; (2) whether there is a grant by necessary implication; or (3) whether the power in question is indispensable to the accomplishment of the object of the corporation.”

It seems to us that the case of Shapard v. City of Missoula, and the Milligan case, from which we have quoted, are conclusive of the proposition that the City of Forsyth is without power or authority to make such a contract, in view of Section 5039.63 of the Revised Codes of Montana of 1935. However, by the great weight of authority, where a method is provided by statute for a municipality to acquire an electric plant, that method is exclusive.

- Fairbanks, Morse & Co. v. City of Wagoner,
86 Fed. (2d) 288;
Kansas Power Co. v. Fairbanks, Morse & Co.,
142 Kan. 109, 45 Pac. (2d) 872;
Whipps v. Town of Greybull, 56 Wyo. 355,
109 Pac. (2d) 805, (decided February 4,
1941);
Van Eaton v. Town of Sidney, 211 Ia. 986, 231
N. W. 475;
Interstate Power Co. of Neb. v. City of Ains-
worth, 125 Neb. 419, 250 N. W. 649;
Ahern v. Richardson County, 127 Neb. 659,
256 N. W. 515;
Hesse v. City of Watertown, 47 S. D. 325, 232
N. W. 53;
Tierney v. Cohen, 268 N. Y. 464, 198 N. E. 225;
Lassen Municipal Utility Dist. v. Hopper, 5
Cal. (2d) 18, 53 Pac. (2d) 347;
State v. McWilliams, 335 Mo. 816, 74 S. W.
(2d) 363.

In the case of Fairbanks, Morse & Co. v. City of Wagoner, above cited, the Circuit Court of Appeals for the Tenth Circuit, in an opinion by Phillips, Circuit Judge, said:

“We conclude that section 27 art. 10, of the Oklahoma Constitution, quoted in note 1 to our former opinion herein (81 Fed. (2d) 209, 212) provides the exclusive method by which a city may finance the cost of an electric power plant, other than from current funds on hand

or presently to be available from lawful tax levies already made from current earnings, or from the proceeds of a bond issue authorized in accordance with section 26, art. 10, of the Oklahoma Constitution.”

Section 27 of Article 10 of the Oklahoma Constitution, quoted in Note 1 to the former opinion of the Court in the same case, in 81 Fed. (2d) 209, reads as follows:

“Sec. 27. Any incorporated city or town in this State may, by a majority of the qualified property taxpaying voters of such city or town, voting at an election to be held for that purpose, be allowed to become indebted in a larger amount than that specified in section twenty-six, for the purpose of purchasing or constructing public utilities, or for repairing the same, to be owned exclusively by such city: * * *.”

In the case of *Kansas Power Company v. Fairbanks, Morse & Co.*, above cited, the court said:

“It seems clear to this court that, since a specific method of financing the establishment of a municipal light and power plant is prescribed by statute, and that statutory method gives no sanction to the proposed method of payment challenged in this action, the contract is illegal in its main features, and this court must so hold.”

In the case of *Whipps v. Town of Greybull*, above cited, in which the appellee herein intervened, the

court in an extended and able opinion reviews the authorities and in the opinion said:

“It seems clear to this court that, since a specific method of financing the establishment of a municipal light and power plant is prescribed by statute, and that statutory method gives no sanction to the proposed method of payment challenged in this action, the contract is illegal in its main features, and this court must so hold.”

In the brief for appellants the cases of Carr v. Fenstermacher, 119 Neb. 172, 228 N. W. 114, and Johnston v. City of Stuart, (Ia.), 226 N. W. 164, are cited and it is said: (pp. 47 and 48 of Appellants' Brief) that the case of Van Eaton v. Town of Sidney, 211 Iowa 986, 231 N. W. 475, is “off-set” by the case of Johnston v. City of Stuart, 226 N. W. (Ia.) 164, and that the case of Interstate Power Company v. Ainsworth, 125 Neb. 419, 250 N. W. 649, is “off-set” by the case of Carr v. Fenstermacher, 119 Neb. 172, 228 N. W. 114. We say that the earlier cases in Nebraska and Iowa cited by appellants were over-ruled by the later cases in those states.

We will not undertake to review the cases cited in the brief for appellants. Several of these cases involve the question of such a contract creating the excessive indebtedness. We are not contending that the contract in question would create any excessive indebtedness. From our reading and analysis of the cases cited by appellants, we believe that we are correct in the statement that the only cases in which

it was decided that the grant of power to a city to acquire a lighting plant on the credit of the city by borrowing money or issuing bonds is merely permissive and does not prohibit the issuance of what are termed revenue bonds, are the cases from North Dakota, Nebraska, Minnesota and Iowa, and the cases from Iowa and Nebraska have been over-ruled by later decisions.

In the case of *Farmers State Bank v. City of Conrad*, 100 Mont. 415, 47 Pac. (2d) 853, the question considered was the power or authority of the City to enter into a contract with the State Water Conservation Board for the procurement of a supply of water for the city. The proposed contract provided for the payment of \$6,000 a year for the supply from revenue to be derived by the City from the operation of the water plant. The City had previously issued bonds for the purpose of procuring a water supply and the plaintiff, who was one of the bondholders, contended that the use of the revenues from the plant for the payment of the additional supply would injure him as a bondholder. The court found against the plaintiff on this issue. It was further contended by the plaintiff that the contract would create an illegal indebtedness. The court decided that such a contract does not create a prohibited indebtedness for the reason that the cost of the additional supply was to be paid for by revenue derived from the operation of the water system. No question was presented as to the authority of the city to make such a contract except that it would violate

the rights of the plaintiff as a bondholder and would create an unlawful indebtedness against the city. The court found that the amount to be paid each year was less than the cost then being paid by the city for pumping and pipe line repair, and in the opinion the court said:

“Expenditure for one is as much operating cost as the other, and no injury done to any interested party. This being true, there is no merit in plaintiff’s contention that using a part of the revenues realized from water sales under a plant established and maintained by virtue of the provisions of section 6 of Article XIII of the Constitution violates any of the provisions of that section.”

Section 5039.63 of the Revised Codes of Montana of 1935 expressly authorizes a city to procure a water supply by devoting the revenues derived therefrom to the payment of the debt.

It thus appears that the method adopted by the city for procuring the water supply was expressly authorized.

If the Legislative Assembly of Montana had intended that a city can procure an electric plant by devoting the revenues therefrom to the payment therefor, it certainly would have so provided as it did with reference to a water supply.

CHAPTER 115, LAWS OF 1937, AS AMENDED IN 1939.

In the brief for appellants, on page 33, it is said that Chapter 115 of the Laws of Montana of

1937, as amended and extended by Chapter 111 of the Laws of 1939, authorizes the construction of any "project" to be paid for solely out of the earnings of such project, and that by virtue of this statute the City has authority "to erect a municipal lighting plant without reference to the provisions of Section 5039.63."

Section 1 of Chapter 115 provided as follows:

"The economic depression prevailing throughout the United States and foreign countries has caused widespread unemployment, poverty, dependency and distress among people in the State of Montana, and to such extent that the public peace, order and tranquillity are seriously endangered, and the orderly processes of government may be imperiled. Local, state and federal means for relief so far made available are hopelessly inadequate. The entire situation constitutes a grave emergency in the history of our State. This emergency is hereby recognized and declared to exist.

In accordance with the fundamental principles and purposes of the government of this nation and of this State, we hereby declare it to be the policy of this legislative assembly to meet the existing emergency by providing public work for unemployed and distressed people throughout the State and thereby 'insure domestic tranquillity and promote the general welfare'."

Section 10 of the Act provided that the act should

“expire and stand repealed on December 31, 1939”. By Chapter 111 of the Laws of Montana of 1939, approved March 3, 1939, the Act was amended by extending the same to March 15, 1941.

Both the original act and the amended act authorized the “procuring of a supply of water for a municipality which shall own and control such water supply and devote the revenues derived therefrom to the payment of the debt”. Nothing whatever is said with reference to the procurement of an electric plant, but there is authority in the original act to contract for the construction of any project to be paid for solely from the earnings of said project, and without liability on the part of the governmental subdivision or agency contracting for the construction of same.

It is a well understood rule of statutory construction that where “one statute deals with a subject in general and comprehensive terms, and another deals with a part of the same subject in a more minute and definite way, the latter will prevail over the former to the extent of any necessary repugnancy between them” (*Barth v. Ely*, 85 Mont. 310, 322, 278 Pac. 1002). This rule is declared by Section 10520 of the Revised Codes of Montana of 1935, reading as follows:

“The intention of the legislature or parties. In the construction of a statute the intention of the legislature, and in the construction of the instrument the intention of the parties, is to be pursued if possible; and when a general and

particular provision are inconsistent, the latter is paramount to the former. So a particular intent will control a general one that is inconsistent with it.”

Applying this rule to Chapter 115, as amended, and Section 5039.63 of the Revised Codes of Montana of 1935, said Chapter 115, as amended, has no reference to an electric lighting plant and such a plant is not a “project” referred to.

This construction is also supported by the fact that by Chapter 115, as amended, authority is expressly conferred to procure “a supply of water for a municipality which shall own and control such water supply and devote the revenues derived therefrom to the payment of the debt”. If it had been intended that a city could, in like manner, procure a lighting plant, it certainly would have been so provided. The rule *expressio unius est exclusio alterius* applies.

As the whole purpose of Chapter 115, as amended, was to provide for the unemployed and distressed people throughout the state during what was declared the “existing emergency”, which the Legislative Assembly determined would end on March 15, 1941, it was clearly intended that any contract made should be performed before the emergency ended. As the contract has not been performed or anything done by either party to carry out the contract, the repeal of Chapter 115, as amended, assuming that the same authorized the making of such a contract, has abrogated the contract.

In 59 Corpus Juris, page 1185, it is said that:

“in the absence of a saving clause or other clear expression of intention, the repeal of a statute has the effect, except as to transactions past and closed, of blotting it out as completely as if it had never existed, and putting an end to all proceedings under it. However, the repeal of a statute will not operate to impair rights vested under it,”

In the case of *Pearsall v. Great Northern R. Co.*, 161 U. S. 646, 673, 40 L. Ed. 838, 847, the court quotes approvingly the definition of vested rights by Mr. Justice Cooley in his work on Constitutional Limitations, as follows:

“It is said by Mr. Justice Cooley that ‘rights are vested, in contra-distinction to being expectant or contingent. They are vested when the right to enjoyment, present or prospective, has become the property of some particular person or persons as a present interest. They are expectant when they depend upon the continued existence of the present condition of things until the happening of some future event. They are contingent when they are only to come into existence on an event or condition which may not happen or be performed until some other event may prevent their vesting’.”

As, by the contract in question, Fairbanks, Morse & Co. were not required to begin work until ten days after “litigation for the ousting of the Power Company” should be “finally determined in favor of the

City”, no rights have vested by virtue of the contract.

★ ★ ★ ★ ★ ★ ★ ★

The District Court decided:

1. That the Court has jurisdiction.
2. That appellee has a franchise.
3. That, by virtue of said franchise, although not exclusive, appellee can maintain this action, and will be protected against illegal competition.
4. That the method provided by the statute for acquiring an electric plant is exclusive and the City was without authority to enter into the contract in question.
5. That the said contract is wanting in mutuality and, therefore, not enforceable.
6. That Chapter 111 of the Laws of 1939 has no application and does not “supersede or modify in any respect the plain and specific mandatory provisions of Section 5039.63 R. C. M.”

The judgment of the District Court should be affirmed.

Respectfully submitted,

E. G. TOOMEY,

Residence and Post Office Address:
Helena, Montana

M. S. GUNN,
CARL RASCH,
MILTON C. GUNN,

Residence and Post Office Address:
Helena, Montana

Attorneys for Appellee.

United States
Circuit Court of Appeals
For the Ninth Circuit

THE CITY OF FORSYTH, a municipal corporation of the
State of Montana, and FAIRBANKS, MORSE & COM-
PANY, a corporation,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY, a corporation,
Appellee.

Petition of Appellee for Rehearing

E. G. TOOMEY,
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Attorneys for Appellee.

FILED

MAY 21 1942

PAUL P. O'BRIEN,
CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit

THE CITY OF FORSYTH, a municipal corporation of the
State of Montana, and FAIRBANKS, MORSE & COM-
PANY, a corporation,

Appellants,

vs.

MOUNTAIN STATES POWER COMPANY, a corporation,
Appellee.

Petition of Appellee for Rehearing

**TO THE HONORABLE THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE NINTH CIRCUIT:**

The appellee, Mountain States Power Company, respectfully petitions the Court for a rehearing in this case upon the ground and for the reason that the reversal should be without prejudice to an application for leave to amend the bill of complaint.

ARGUMENT

In the opinion the Court said :

“Appellants contend that the matter in controversy is appellee’s alleged right to continue in operation free of interference by appellants. Appellee contends that the matter in controversy ‘is the value to the appellee of its alleged franchise and the value to the appellants

of the contract for the construction of a municipal plant, at a cost of \$169,969.00'. It is unnecessary to decide which of these contentions is correct because *there is no allegation of any kind stating or showing the value of any of such rights*. Therefore jurisdiction does not affirmatively appear within the rule that 'the jurisdiction of a federal court must affirmatively and distinctly appear and cannot be helped by presumptions or by argumentative inferences drawn from the pleadings'. Norton v. Larney, 266 U. S. 511, 515. (Italics ours.)

Other questions presented need not be considered.

The judgment is reversed and the cause is remanded to the court below with directions to dismiss the complaint for want of jurisdiction."

It is apparent that the bill of complaint can be amended by alleging the value of each of the rights referred to and the value of appellees franchise. The District Court, however, is directed to dismiss the complaint and, therefore, could not permit such an amendment.

It appears to be the rule recognized by the Supreme Court of the United States and by the Circuit Courts of Appeals that where there is a dismissal for want of jurisdiction, because of a failure to allege the jurisdictional facts, and it is apparent that the jurisdictional facts could be made to appear by an amendment, the appellate court, instead of directing a dismissal for want of jurisdiction, should make the dismissal conditional upon the failure to amend.

Stuart v. City of Easton, 156 U. S. 46, 39 L. Ed. 341;

Morgan v. Gay, 19 Wallace 81, 22 L. Ed. 100;

Horne v. George H. Hammond Co., 155 U. S. 393, 39 L. Ed. 197;

Menard v. Goggan, 121 U. S. 253, 30 L. Ed. 914;

N. P. Ry. Co. v. Walker, 148 U. S. 391, 37 L. Ed. 494;

Newcomb v. Burbank, 181 Fed. 334;

Tinsley v. Hoot, 53 Fed. 682.

In the case of Thomson v. Gaskill, decided by the Supreme Court of the United States on March 2, 1942, in concluding the opinion, the court said:

“The record contains no showing of the requisite jurisdictional amount, and the District Court was therefore without jurisdiction. The judgment will be reversed and the cause remanded to the District Court without prejudice to an application for leave to amend the bill of complaint.” (Supreme Court Law Ed. Advance Opinions, Vol. 86, No. 9, p. 611).

In the case of McNutt v. General Motors Acceptance Corporation, 298 U. S. 178, 80 L. Ed. 1135, in which it was decided that the record did not show the jurisdictional amount, the Court ordered the dismissal of the complaint without any reservation of the right to amend. The order does not appear to have been questioned. Whether the order was made inadvertently or upon the assumption that the complaint could not be amended so as to show the jurisdictional amount does not appear. In any event, the case of Thomson v. Gaskill, above cited, is the latest case of a reversal because the record failed to show the jurisdictional amount.

It was contended by appellants, as appears from their briefs, that the jurisdictional amount in this case is determined by the loss which appellee would suffer from competition, and that such loss is *damnum absque injuria* for the reason that the appellants' franchise, if it has a franchise, is not exclusive. On the other hand, it is contended by appellee

that, although its franchise is not exclusive, it is entitled to injunctive protection against illegal competition and that the City was without authority to make the contract in question, and, furthermore, that the contract is void for want of mutuality, by reason of which the competition would be illegal. The allegation of the complaint that the appellee has a franchise is denied.

It thus appears that the complaint can be amended to show the jurisdictional amount by alleging the value of the right of the appellee to be free from illegal competition, the value of the right of the City to own and operate an electric plant as contemplated, and the value of appellee's alleged franchise.

Rule 15 of the Rules of Federal Procedure of the District Courts of the United States provides that leave to amend "shall be freely given when justice so requires".

Respectfully submitted,

E. G. TOOMEY,

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M. S. GUNN,

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Residence and Postoffice
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Helena, Montana.

Attorneys for Appellee.

THIS IS TO CERTIFY that in my judgment the foregoing Petition for Rehearing is well founded and that said petition is not interposed for delay.

M. S. GUNN,

Of Counsel for Appellee.

15

United States
Circuit Court of Appeals
For the Ninth Circuit.

CHARLES EVAN FOWLER,

Appellant,

vs.

CALIFORNIA TOLL-BRIDGE AUTHORITY,
Appellee.

Transcript of Record

Upon Appeal from the District Court of the United
States for the Northern District of California,
Southern Division.

FILED

JAN 2 - 1942

PAUL P. O'BRIEN,

CLERK



United States
Circuit Court of Appeals

For the Ninth Circuit.

CHARLES EVAN FOWLER,

Appellant,

vs.

CALIFORNIA TOLL-BRIDGE AUTHORITY,

Appellee.

Transcript of Record

**Upon Appeal from the District Court of the United
States for the Northern District of California,
Southern Division.**

INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

Page

Appeal:

Designation of contents of record on 23

Notice of 18

Statement of points on (Circuit Court of Appeals) 22

Statement of points on (District Court)..... 19

Attorneys, Names and addresses of 1

Certificate of Clerk 20

Complaint, Amended 2

Designation of contents of record on appeal..... 23

Motion to dismiss amended complaint 6

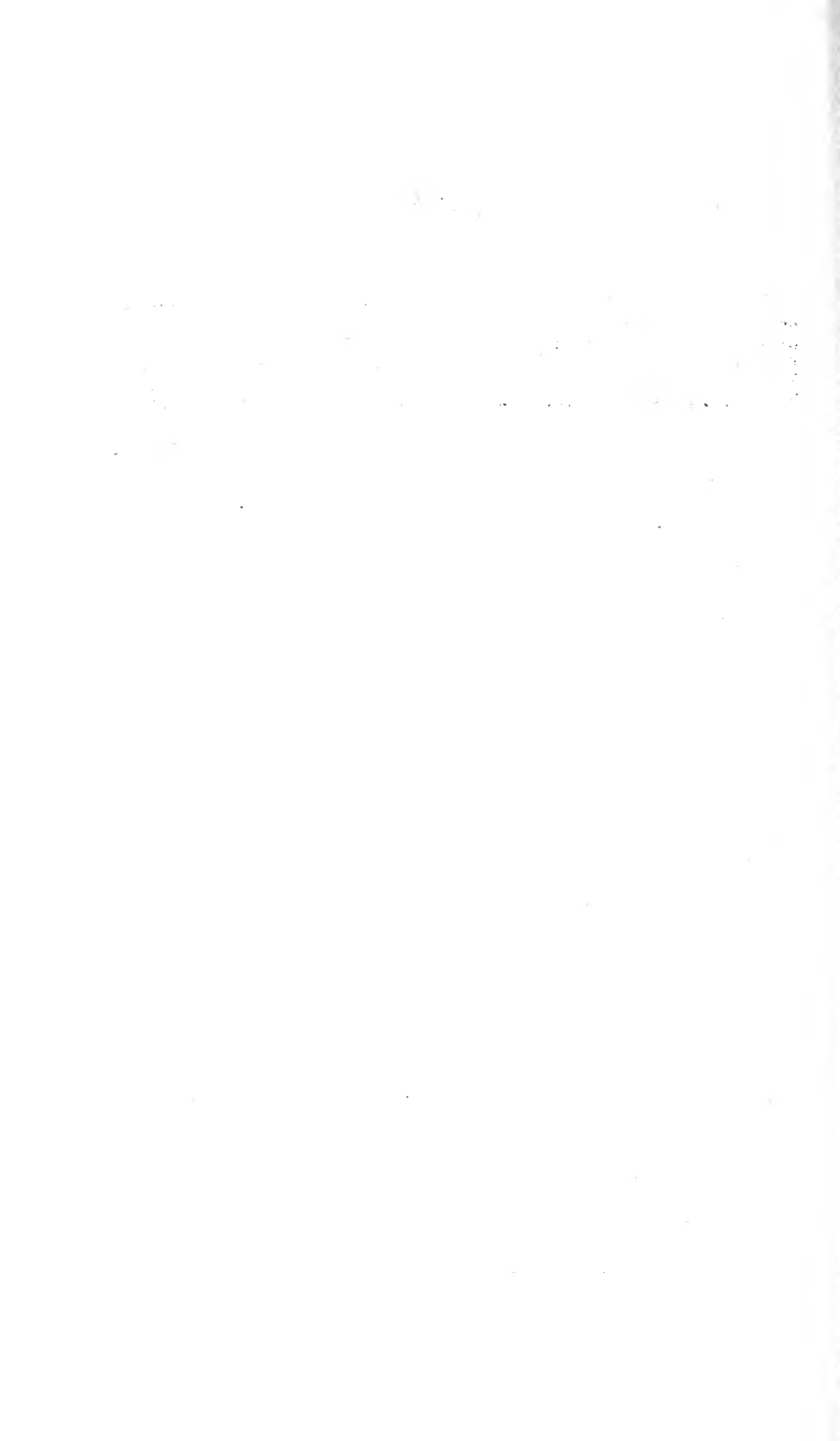
Names and addresses of attorneys 1

Notice of appeal 18

Opinion, Memorandum and order granting motion to dismiss 10

Statement of points on appeal (Circuit Court of Appeals) 22

Statement of points on appeal (District Court) 19



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On appeal from the United States District Court
for the Northern District of California, Southern
Division.

Decision by Judge Martin I. Welsh.

In the United States District Court, for the Northern District of California, Southern Division.

No. 21412 W

CHARLES EVAN FOWLER,

Plaintiff,

vs.

CALIFORNIA TOLL-BRIDGE AUTHORITY,

Defendant.

AMENDED COMPLAINT

Comes Now the plaintiff, Charles Evan Fowler, and by leave of court first had and obtained, files this his Amended Complaint and alleges:

I.

That the defendant, California Toll-Bridge Authority, is a public board and agency of the State of California, duly created by the Statutes of California, Statutes of 1929, page 1489 and amendments thereto (Act 956 General Laws); that said act provides that the defendant may be sued in its own name; that defendant has its place of business and is a resident of the State of California; that plaintiff is a resident and citizen of the State of Louisiana; that the matter in controversy herein exceeds, exclusive of interest and costs, the sum of Three Thousand Dollars (\$3,000.00). [1*]

*Page numbering appearing at foot of page of original certified Transcript of Record.

II.

That heretofore plaintiff, by his studies and labor, prepared plans for three different designs, together with complete estimates, for a bridge to be built across San Francisco Bay from the City and County of San Francisco to the City of Oakland, County of Alameda; that said plans called for said bridge to extend upon and through Yerba Buena Island as the pivotal point; that such structure was to cost in excess of Seventy-five Million Dollars (\$75,000,000.00); that said plans and estimates called for double deck structures with roadways on the upper deck and rapid transit tracks on the lower deck.

That said plans were designated as follows: Plan "A" which called for three 2000 feet Cantilever spans over the main channel of said Bay from San Francisco to Yerba Buena Island; Plan "B", for three 2400 feet suspension spans over said channel; and Plan "C" for three 2300 feet Cantilever spans over said channel.

That all of the said plans, designs and estimates provided for a Cantilever span, five fixed spans and a Viaduct approach from said Yerba Buena Island to the mainland of Oakland, County of Alameda.

III.

That plaintiff prepared a fourth plan with estimates, known as Plan "D", which provided for a 4850 feet suspension span with two 2425 feet side spans over the said main channel, with the same Alameda County approach as in the other designs.

IV.

That during all the times herein mentioned plaintiff was and now is the sole owner of all of said plans.

V.

That the defendant has appropriated and used the plans and designs so prepared by the plaintiff, as aforesaid, without [2] the consent of and against the will of plaintiff, and in particular has so appropriated the said Design "B" in its entirety; that defendant used said plans and designs to construct a bridge across San Francisco Bay from the City and County of San Francisco to the City of Oakland, in Alameda County, using Yerba Buena Island as the pivotal point of said bridge; that said bridge was completed on or about the 15th day of January, 1939.

VI.

That the cost of said bridge was in excess of Seventy-five Million Dollars (\$75,000,000.00), the exact cost of which is not known to plaintiff; that upon the completion thereof the defendant became indebted to the plaintiff in and for an amount equal to three per cent. (3%) of the cost of said bridge; that said sum is the reasonable value of said plans, designs and estimates so used and appropriated by the defendant, as aforesaid, and the amount of damages which plaintiff has suffered on account of said use and appropriation.

VII.

That said Designs "A", "B" and "C" were fully set forth and described in the plans, specifications, estimates and information, which plaintiff exhibited to a Board of United States Engineers at a hearing held in the year 1916 in the City and County of San Francisco, with regard to the bridging of San Francisco Bay between said City and County of San Francisco and said City of Oakland; that plaintiff also exhibited said designs to the members of the Hoover-Young Commission, sitting with regard to the same matter; that said same designs and plans thereafter came into the hands of the defendant, its agents and servants, and were used in the construction of said bridge, as hereinabove alleged.

Wherefore, plaintiff prays for judgment against the defendant for the sum of Two Million Two Hundred Fifty Thousand [3] Dollars (\$2,250,000.00), which is three per cent (3%) of the sum of Seventy-five Million Dollars (\$75,000,000.00), and for three per cent (3%) of any additional sum it may be found that the construction of said bridge cost, over and above said sum of Seventy-five Million Dollars (\$75,000,000.00), for his costs of suit and for such other and further relief as may be meet and just in the premises.

THOMAS C. RYAN,

DANIEL V. RYAN,

Attorneys for Plaintiff.

(Receipt of Service)

[Endorsed]: Filed Feb. 3, 1941. [4]

[Title of District Court and Cause.]

MOTION TO DISMISS AMENDED
COMPLAINT

To the Plaintiff Above Named:

Please take notice that on Monday, the 24th day of March, 1941, at the hour of 10:00 A. M. of said day, or as soon thereafter as counsel can be heard, in the courtroom of Honorable Martin I. Welsh, Judge of the above entitled Court, in the Post Office Building, Seventh and Mission Streets, San Francisco, California, the defendant California Toll Bridge Authority will move the above entitled Court to dismiss the amended complaint of the above named plaintiff. [5]

Said motion will be made and based upon all the papers and proceedings on file herein, including this notice of motion, and will be made upon the grounds of:

1. Failure of the said complaint to state a claim or cause of action upon which relief can be granted; and

2. That said action does not plead facts to show the compliance of conditions precedent, as provided for and prescribed in Political Code sections 686 to 692 inclusive and 677; and

3. That this said Court has no jurisdiction over the subject matter or the defendant; and

4. That there is a non-joinder of party defendant; and

5. That said action is barred by the provisions of Sections 339 (1), 338 (3), and 343 of the Code of Civil Procedure of the State of California.

POINTS AND AUTHORITIES IN SUPPORT
OF MOTION TO DISMISS

1. Analysis of the Complaint

Counsel for the plaintiff sets forth in his Points and Authorities in opposition to motion to dismiss previously made by said defendant, and heretofore filed by counsel for said plaintiff, in which plaintiff specifies that his said complaint in its original condition states a cause of action on two alternative theories. The amended complaint with the exception of a few minor allegations is practically word for word as was the original. Plaintiff's counsel contends that the two alternative theories of his pleading is (1) implied contract and (2) it is a cause of action for an infringement of plaintiff's common law copyright of the idea and design of the Bay Bridge. I interpret the last alternative view of the cause of action as one in tort of the right coming from plaintiff's common law copyright cause of action or the California statutory copyright cause of action which, of course, is such a claim as would [6] necessarily arise from a statutory enactment.

Whatever the cause of action may be or its theory is immaterial for the following reasons: No complaint can be filed against the State of California without its permission. It is true that the California Toll Bridge Authority statute expressly provides that the Authority may be sued in its own name against the Authority as a statutory agency of the State, and any cause of action or claim must be

asserted against the State. Political Code section 688 provides a specific procedure for asserting claims against the State of California and the necessary steps that must be taken for rejection of any claim. The cases hold uniformly that if the State gives its consent to be sued they can satisfy the procedural steps that must be taken in order to have a claim against the State to be successfully prosecuted.

In 1929 section 688 was amended to provide: "a claim on an express contract or for negligence against the State must be presented" etc. In the amended Statute of 1929 the word "express" was added to limit the claims arising under contract. This definitely intended to eliminate an implied contract or a statutory cause of action.

This principle of law is exemplified by

Berryessa Cattle Co. v. Sunset Pac. Oil Co.
(Jan. 18, 1937)

Circuit Court of Appeal, District 9 in 87
Fed 2nd (2d) 972

It will be noticed that there are no allegations in the complaint setting forth a compliance with Political Code sections 677, and 686 to 692.

The cases moreover hold that in compliance with these statutes there is a condition precedent to the establishment of the cause of action.

See also—

Rose v. Cal. 99 CAD 149

decided in the Supreme Court of California July 29, 1940 at 100 [7] CD page 23, that a rehearing of

Supreme Court decision was granted by the Supreme Court recently and is still under submission. The dissenting opinion in 100 CD 23 discusses in some detail the necessity of complying with the Political Code section 688. However, the original case upon which defendant relies is the above mentioned opinion of the Circuit Court of Appeals.

2. We are not amplifying in this memorandum what the point of contention is in our second phase of our motion to dismiss concerning the non-compliance with the statute.

3. Upon our third contention with respect to the absence of jurisdiction of this Court, substantial reasons are set forth above with respect to points 1 and 2 applying to the phase of the argument that this Court has no jurisdiction.

4. Upon our fourth contention we take the position that the real party in interest is the State of California and should be so sued even though the Statute provides that the California Toll Bridge Authority may be sued in its own name.

5. With respect the fifth contention, it has heretofore been argued before this Honorable Court and it has been ruled that the statute of limitations would not bar this cause of action. We accept this ruling to be the order of the Court but respectfully urge the grounds for the operation of the statute of limitations for the purpose of protecting the inter-

ests of the State on this point, should it be of any advantage to the State to do so.

Respectfully submitted,

LEO A. CUNNINGHAM,

Attorney for Defendant & Executive Officer of said
Authority.

(Receipt of Service)

[Endorsed]: Filed March 12, 1941. [8]

In the United States District Court, for the
Northern District of California, Southern Division.

No. 21412 W

CHARLES EVAN FOWLER,

Plaintiff,

vs.

CALIFORNIA TOLL-BRIDGE AUTHORITY,
Defendant.

MEMORANDUM OPINION AND ORDER
GRANTING MOTION TO DISMISS

The defendant, California Toll Bridge Authority, moves to dismiss this action for, among other stated grounds, want of jurisdiction in this court to hear and determine the controversy because the defendant is in reality the State of California. This action is one to recover damages for an alleged appropriation and unauthorized use by the defend-

ant, in the construction of the San Francisco Bay Bridge, of plans and designs for such bridge prepared and owned by the plaintiff. No Federal question is presented by the allegations of plaintiff's complaint. The only ground on which the jurisdiction of this court is invoked is an alleged diversity [10] of citizenship. If the defendant is in reality the State of California, then there is no diversity of citizenship, for a State is not a citizen. And, consequently, there can be no jurisdiction in this court.

Postal Telegraph Cable Co. vs. Alabama, 155
U.S. 482, 487; 155 Sup. Ct. 192, 194; 39
L. Ed. 231.

And the court is not limited in its inquiry into the citizenship status of the parties, for the purpose of determining its jurisdiction, to an examination solely of the parties of record. If it appears that one of the parties is in reality, although not in name, a State, jurisdiction dependent upon a diversity of citizenship must fail.

“As to what is to be deemed a suit against a state, the early suggestion that the inhibition might be confined to those in which the state was a party to the record has long since been abandoned, and it is now established that the question is to be determined not by the mere names of the titular parties but by the essential nature and effect of the proceeding, as it appears from the entire record.”

In re State of New York et. al. 41 Sup. Ct.
588; 256 U.S. 490.

Furthermore, the non-existence of a diversity of citizenship in such case is not cured by any consent on the part of the State to suit, or any voluntary submission to the jurisdiction of the court, or any waiver of immunity from suit.

State Highway Commission of Wyoming vs.
Utah Construction Co. 49 Sup. Ct. 104;
278 U. S. 194.

We come now to a consideration of the question of whether the defendant in this case is in reality the State of California.

The California Toll Bridge Authority, hereafter referred to as "The Authority", was created by act of the California State Legislature as an instrumentality to aid the State of [11] California in effectuating its declared policy of acquiring and owning all toll bridges situated on or along any part of the state's highways with the end in view of ultimately eliminating all toll charges. (Statutes, 1929, p. 1489)

The Authority consists of a board of five members, all state officials, acting without compensation. The Authority, in conjunction with the Department of Public Works of the State, determines upon the necessity and desirability of acquiring or constructing any particular toll bridge or other toll highway crossing. If its determination is favorable to the acquisition or construction of any such toll bridge or toll crossing, the Authority is empowered to direct the Department of Public Works to pro-

ceed therewith for and in the name of the State of California, and to issue revenue bonds to finance the same. These bonds are issued in the name of the California Toll Bridge Authority and are secured wholly by lien upon the tolls and other revenue obtained from the operation of the particular toll bridge or crossing for the acquisition or construction of which the bonds are issued, and do not constitute obligations of the State. The bonds are signed by the Director of Public Works and countersigned by the Governor. The proceeds from the sale of bonds are paid into the State Treasury and credited to a fund designated the acquisition and construction fund, and used primarily for that purpose. Disbursements from this fund are made upon demand of the Department of Public Works upon warrants drawn by the State Controller. The Department of Public Works, acting for and in the name of the State of California, has charge of the designing, acquisition and construction of all such toll bridges and other toll highway crossings, and of such transportation facilities connected therewith as may be authorized by The Authority, and of the operation and [12] maintenance of the same. All tolls or other revenue received from the operation of any toll bridge or toll highway crossing are collected by the Department of Public Works and paid into the State Treasury. These funds are disbursed primarily for purposes of bond redemption and interest payments upon warrants drawn by the State Controller at the request of the Treasurer, and for

purposes of acquisition, construction, operation and maintenance of toll bridges and toll highway crossings upon demand of the Department of Public Works upon warrants drawn by the State Controller. Whenever proceedings in eminent domain are required to be taken in connection with the acquisition or construction of any toll bridge, toll highway crossing, or transportation facilities connected therewith, such proceedings are taken by the Department of Public Works, upon direction of the Authority, in the name of the State of California. The Authority is empowered to prescribe the terms and conditions upon which transportation service may be conducted over any state owned toll bridge or highway crossing, and to grant permits therefor. The Authority, if it deems it to be to the best interest of the State, may enter into contracts with transportation companies or with political subdivisions for the use of transportation facilities over any toll bridge or toll highway crossing. Or, if it deems it to be for the best interest of the State, the Authority may itself in behalf of the State operate the transportation facilities of any such toll bridge or crossing. The Authority is also empowered to fix the form, conditions and denominations of the revenue bonds it issues, and to enter into contracts and incur various obligations in connection with its authorized activities. And it may sue and be sued. [13]

In all its functions, the Authority is representing and assisting the State in the performance of a tra-

ditional governmental function, that of building, operating and maintaining bridges and highway crossings as a part of the government system of state highways. The Authority is not a distinct and separate entity embarked upon a profit making commercial enterprise in competition with private citizens. The Authority owns no property. The bridges belong to the State. It has no capital stock. It derives no income to itself. All tolls and revenues received from the operation of the bridges are paid into the State Treasury and become state funds. The members of the Authority are all state officials none of whom receive any compensation for the services they perform as members of The Authority in addition to their regular salaries received for their services to the State. The Authority may make contracts and incur obligations, but it is not itself able to respond financially to any judgment which may be recovered against it. The holder of any such judgment would have to look to the State and to state funds for satisfaction thereof. The Authority does not act in any proprietary capacity. All of its acts are done for and on behalf of the State of California in the performance of a traditional governmental function. Finally, the Authority is in reality the State of California. And a suit against the Authority as an entity to recover a money demand, is in reality a suit to recover against the State of California.

We are not without direct authority for our position. In the case of *Kansas City Bridge Co. vs.*

Alabama State Bridge Corporation, 59 Fed. Rep. (2nd) 48, an action on contract was brought in the United States District Court against the Alabama State Bridge Corporation. Jurisdiction was based upon [14] diversity of citizenship. Judgment rendered for the defendant upon demurrer was affirmed on appeal on the ground that the State of Alabama was the real party in interest. In this case it appeared that the organization, purpose, powers and functions of the defendant, Alabama State Bridge Corporation was in all substantial details the same as the California Toll Bridge Authority. On page 49, the court in holding that a suit against the Alabama State Bridge Corporation was a suit against the State of Alabama, said:—

“It is clear that the whole purpose of the act was to erect bridges essential to the highway system, to pay for them with tolls, and then to make them free for the use of the public. It is well settled that the construction of public roads and bridges is a governmental function . . . The state may either perform this function in its own name or through its public officers or one of its governmental agencies. . . . The Alabama Bridge Corporation was but an agency or instrumentality through which the state acted in causing its public bridges to be constructed. It was not a private corporation in any sense of the word, but state officials, who might as well have been designated a board or commission, were *ex officio* members, and the

only members, of it . . . In the nature of things that state had to choose some such agency in order to effectuate its purpose . . . We are of the opinion, therefore, that this is a suit against the state of Alabama.”

In the case of *State Highway Commission in Arkansas vs. Kansas City Bridge Company*, 81 Fed. Rep. (2nd) 689, it was held that a suit against the Arkansas State Highway Commission was in reality a suit against the State of Arkansas and consequently could not be instituted in the Federal Court on the ground of a diversity of citizenship. On page 690, the court stated:—

“That under the laws of Arkansas the commission is a state agency performing governmental functions with respect to the construction and maintenance of state highways is not disputed. That it was acting as such agency in entering into the contract which is the basis of this suit is likewise undisputed. [15] The revenues available for meeting obligations incurred by that commission were state revenues. . . . The legal effect of the contract would be the same whether it stated that it was made by the state through the commission or by the commission itself. In either event, it would be a contract made and executed by an agency of the state on behalf of the state. Moreover, the purpose of this suit was to require the state to make pecuniary satisfaction for a liability

which, it has been held, would make the suit one against the state.”

In the instant case, we hold that the defendant is in reality the State of California. Since there is no diversity of citizenship, there is no jurisdiction in this court. The provision of law authorizing the defendant to sue and be sued cannot supply the jurisdictional prerequisite of diversity of citizenship which is lacking here. (State Highway Commission of Wyoming vs. Utah Construction Co. 49 Sup. Ct 104; 278 U. S. 194)

It Is Therefore Ordered, that the motion of the defendant to dismiss this action be and the same is hereby Granted.

Dated: August 14, 1941.

MARTIN I. WELSH,

United States District Judge.

[Endorsed]: Filed Aug. 14, 1941. [16]

[Title of District Court and Cause.]

NOTICE OF APPEAL TO
CIRCUIT COURT OF APPEALS

Notice is hereby given that Charles Evan Fowler, plaintiff above-named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit, from the Order Granting Motion to Dismiss the Amended Complaint of plaintiff herein, which or-

der was entered in this action on the 14th day of August, 1941.

Dated: October 30, 1941.

THOS. C. RYAN,
#1224 Hearst Building
San Francisco, California.

DANIEL V. RYAN,
435 Russ Building
San Francisco, California.

[Endorsed]: Filed Oct. 30, 1941. [17]

[Title of District Court and Cause.]

STATEMENT OF POINTS RELIED UPON
ON APPEAL

The only points plaintiff and appellant relies upon on appeal herein, are the following: (1) Appellant contends that there is a diversity of citizenship between the parties hereto; (2) that the above Court has jurisdiction of the parties and the subject matter of the above action; and (3) that defendant is a separate entity from the State of California.

Dated: October 30, 1941.

THOS. C. RYAN,
#1224 Hearst Bldg.
San Francisco, California
DANIEL V. RYAN,
435 Russ Building
San Francisco, California
Attorneys for Plaintiff
and Appellant.

(Receipt of Service)

[Endorsed]: Filed Oct. 30, 1941. [18]

District Court of the United States
Northern District of California

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD ON APPEAL

I, Walter B. Maling, Clerk of the District Court of the United States, for the Northern District of California, do hereby certify that the foregoing 19 pages, numbered from 1 to 19, inclusive, contain a full, true, and correct transcript of the records and proceedings in the case entitled Charles Evan Fowler, Plaintiff, vs. California Toll-Bridge Authority, Defendant. No. 21412-W., as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of Three dollars and five cents

(\$3.05) and that the said amount has been paid to me by the Attorney for the appellant herein.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 8th day of December A.D. 1941.

(Seal)

WALTER B. MALING,
Clerk.

WM. J. CROSBY,
Deputy Clerk.

[Endorsed]: No. 9992. United States Circuit Court of Appeals for the Ninth Circuit. Charles Evan Fowler, Appellant, vs. California Toll-Bridge Authority, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed December 8, 1941.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit.

U.S.C.C.A. 9992
D.C. No. 21412 W

CHARLES EVAN FOWLER,

Plaintiff,

vs.

CALIFORNIA TOLL-BRIDGE AUTHORITY,
Defendant.

ADOPTION OF STATEMENT OF POINT
UPON WHICH APPELLANT INTENDS
TO RELY FILED HERETOFORE WITH
THE CLERK OF TRIAL COURT.

To the Above Entitled Court:

Appellant, Charles Evan Fowler, hereby adopts as a statement of points upon which he intends to rely upon the appeal herein, the statement of points heretofore filed with the Clerk of the United States District Court, for the Northern District of California, Southern Division.

Dated: December 8, 1941.

THOS. C. RYAN,

#1224 Hearst Building
San Francisco, California

DANIEL V. RYAN,

#435 Russ Building
San Francisco, California

Attorneys for Plaintiff.

Received a copy December 9, 1941.

LEO A. CUNNINGHAM

[Endorsed]: Filed Dec. 9, 1941. Paul P. O'Brien,
Clerk.

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF
RECORD ON APPEAL

Plaintiff and Appellant, Charles Evan Fowler,
hereby designates the portion of the record and
proceedings to be contained in the record on appeal
herein.

Such contents are as follows: One (1) The
Amended complaint of plaintiff filed herein. Two
(2) The Motion to Dismiss the Amended Complaint.
Three (3) The Memorandum Opinion and Order
Granting Motion to Dismiss. Four (4) The Notice
of Appeal.

Dated: December 8, 1941.

THOS. C. RYAN,

#1224 Hearst Building

San Francisco, California

DANIEL V. RYAN,

435 Russ Building

San Francisco, California

Attorneys for Plaintiff
and Appellant.

[Endorsed]: Filed Dec. 9, 1941. Paul P. O'Brien,
Clerk.

16
No. 9992

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

CHARLES EVAN FOWLER,

Appellant,

VS.

CALIFORNIA TOLL-BRIDGE AUTHORITY,

Appellee.

**Appeal from Order of United States District Court
Dismissing Action.**

BRIEF FOR APPELLANT.

DANIEL V. RYAN,

Russ Building, San Francisco,

THOMAS C. RYAN,

Hearst Building, San Francisco,

Attorneys for Appellant.

FILED

JAN 16 1942

PAUL P. O'BRIEN,

Subject Index

	Page
Jurisdictional Statement	1
Statement of the Case.....	2
Specification of Errors	3
Argument	4

Table of Authorities Cited

Cases	Pages
American Cotton Oil Co. v. United States Fleet Corp., 270 Fed. 296	9
Barrow Steamship Co. v. Kane, 170 U. S. 100, 42 L. Ed. 964	11
California Toll Bridge Authority v. Wentworth, 212 Cal. 298, 298 Pac. 485.....	5
Hunkin-Conkey Construction Co. v. Pennsylvania Turnpike Commission, 34 Fed. Supp. 26.....	5, 6
Keifer & Keifer v. Reconstruction Finance Corp., 306 U. S. 381, 86 Law. Ed. 784.....	9
Postal Telegraph Cable Co. v. Alabama, 155 U. S. 482, 39 Law. Ed. 231	3
Reconstruction Finance Co. v. Minehan Corp., 312 U. S. 81, 85 Law. Ed. 595.....	10
Sloan Shipyards Corporation v. U. S. Shipping Board Emergency Fleet Corp., 258 U. S. 549, 66 Law. Ed. 762..	9
State of Missouri Homestead Life Assoc., 90 Fed. (2d) 543	8

Codes and Statutes

California Statutes of 1929, page 1489, Deering's General Laws of the State of California, Act 956.....	2, 4
U. S. Code Annotated, Title 28, Sec. 41, subsection 1.....	1, 3
U. S. Code Annotated, Title 28, Sec. 225.....	1

No. 9992

IN THE

United States Circuit Court of Appeals
For the Ninth Circuit

CHARLES EVAN FOWLER,

vs.

CALIFORNIA TOLL-BRIDGE AUTHORITY,

Appellant,

Appellee.

Appeal from Order of United States District Court
Dismissing Action.

BRIEF FOR APPELLANT.

JURISDICTIONAL STATEMENT.

The United States District Court dismissed the action herein for want of jurisdiction of the parties hereto. Appellant claims that the District Court did have jurisdiction of said parties on the ground of diversity of citizenship. Jurisdiction of the United States District Court for the Northern District of California is based upon Title 28, Section 41, subsection 1 of the United States Code Annotated.

Appellate jurisdiction of this Court is predicated upon United States Code Annotated, Title 28, Section 225.

The amended complaint herein, paragraph I thereof (Tr. of Record, p. 2) alleges that the defendant was created by the Statutes of the State of California, Statutes of 1929, page 1489 and amendments thereto, Act 956, General Laws. Said statute created the defendant as a corporation. Plaintiff further alleges in said paragraph that he is a resident and citizen of the State of Louisiana; that the matter in controversy, exclusive of interest and costs, exceeds the sum of three thousand dollars (\$3,000.00).

STATEMENT OF THE CASE.

Plaintiff, a citizen of the State of Louisiana, sued the California Toll Bridge Authority, a corporation, a citizen of the State of California, in the United States District Court, in and for the Northern District of California.

In his amended complaint plaintiff alleges that he prepared certain designs and estimates for a bridge across San Francisco Bay from the City and County of San Francisco, to the City of Oakland, County of Alameda; that plaintiff is the sole owner of said plans and specifications; that the defendant appropriated and used the plans so prepared by the plaintiff without his consent and against his will; that defendant used said plans and designs to construct the present bridge across San Francisco Bay from San Francisco to Oakland; that by reason of said facts defendant became indebted to plaintiff to the extent of 3% of

\$75,000,000.00, the cost of the bridge, which he alleges is the reasonable value of said plans, designs and estimates so appropriated by the defendant and which he claims is the amount of damages he suffered on account of the said use and appropriation.

To this amended complaint the defendant filed a motion to dismiss on several grounds. The main ground, and the one on which the lower Court granted said motion, was that there was no diversity of citizenship between plaintiff and defendant, because the defendant was in reality the State of California and hence not a citizen of California (*Postal Telegraph Cable Co. v. Alabama*, 155 U. S. 482, 39 Law. Ed. 231), and that, therefore, the United States District Court had no jurisdiction over the parties to this action.

It is appellant's contention that the California Toll Bridge Authority is a separate entity from the State of California; that it is a corporation organized and existing under and by virtue of the laws of the State of California and hence a citizen of California, and that, therefore, there was a diversity of citizenship under Title 28, Section 41, subsection 1 of the United States Code Annotated, and the Court had jurisdiction of the parties hereto.

SPECIFICATION OF ERRORS.

1. The District Court erred in its decision holding that there was no diversity of citizenship between the parties hereto.

2. The District Court erred in holding that the defendant was in reality the State of California and not a separate entity.

3. The District Court erred in holding that it did not have jurisdiction of the parties and the subject matter of this action.

ARGUMENT.

The California Toll Bridge Authority was created by an act of the legislature of the State of California.

California Statutes of 1929, page 1489, Act 956,
Deering's General Laws of the State of California.

Section 3 of said Act provides that the California Toll Bridge Authority may sue and be sued in its own name. Section 4 provides that the Authority shall authorize and direct the Department of Public Works of the state to build toll bridges and to pay for the same out of any fund or funds provided, or made available by this Act.

Section 5 provides that the revenue bonds authorized for the acquisition, or construction of a toll bridge, shall be issued in the name of the California Toll Bridge Authority and shall constitute obligations only of California Toll Bridge Authority and shall be identified as toll bridge bonds and shall contain a recital on the face thereof that the payment or redemption of said bonds and the payment of the interest

thereon, is secured by a direct and exclusive charge and lien upon the trust and other revenue of any nature whatever received from the operation of the particular toll bridge, for the acquisition or construction of which the bonds are issued and that neither the payment of the principal, or any part thereof, or any interest thereon, constitutes a debt, liability or obligation of the State of California.

Section 6 provides that the Authority may raise funds for the construction of a bridge from revenue bonds, which it may sell from time to time in such amounts as may be deemed necessary in its judgment.

Section 10 of said Act provides that the bonds issued under the provisions of the Act shall not constitute, or be a debt, liability, or obligation of the state, and that the payment of both principal and interest of all such bonds shall be secured only by the trust, or other revenue collected from the particular toll bridge, for which such bonds were issued, and other revenues and interests thereon, and sinking funds created therefrom received by the California Toll Bridge Authority, and shall be paid from such trust or revenue.

The Supreme Court of the State of California, in the case of *California Toll Bridge Authority v. Wentworth*, 212 Cal. 298, 298 Pac. 485, held that the bonds proposed to be issued by said Authority, do not constitute debts of the state.

A situation directly comparable to the case here involved was before the District Court of Pennsylvania, in the case of *Hunkin-Conkey Construction Co. v.*

Pennsylvania Turnpike Commission, 34 Fed. Supp. 26 (1940). In that case the plaintiff, an Ohio corporation, brought an action in the Federal Court in Pennsylvania for a declaratory judgment against the Pennsylvania Turnpike Commission, the complaint alleging that the plaintiff and defendant were residents and citizens of different states. The complaint further alleged that the plaintiff and the defendant entered into a contract for the construction of a tunnel, which was part of the Pennsylvania Turnpike highway between Pittsburgh and Harrisburg, Pennsylvania and that a controversy had arisen over the terms of the contract which the plaintiff asked the Court to decide. The defendant moved to dismiss the complaint upon the ground that the Court was without jurisdiction under the provisions of the United States Code to therein determine the controversy on the ground that there was no diversity of citizenship, alleging that the Commission was in reality the State of Pennsylvania and therefore not a citizen. The Pennsylvania Turnpike Commission was created by the legislature of the State of Pennsylvania. The Act creating the Commission provided:

“That there is hereby created a Commission to be known as “The Pennsylvania Turnpike Commission” and by that name the Commission may sue and be sued. * * * The Commission is hereby constituted an instrumentality of the commonwealth and the exercise by the Commission of the powers conferred by this Act in the construction, operation and maintenance of the turnpike, shall be deemed to be an essential governmental function of the commonwealth.”

The Court, in deciding that the Pennsylvania Turnpike Commission was a separate entity from the State of Pennsylvania and hence a citizen of that state, stated:

“This provision, if taken alone, sheds light upon the question of whether or not the Commission is in fact the alter ego of the State. However, the other provisions of the act, when considered in conjunction with this section, clearly indicate that the Commission is distinct and separate from the State and is in reality a citizen thereof. The act provides that the entire cost of the turnpike shall be paid in the first instance from a fund which is to be raised by the issuance and sale of bonds, and that the ‘turnpike revenue bonds issued under the provisions of this act shall not be deemed to be a debt of the Commonwealth or a pledge of the faith and credit of the Commonwealth, but such bonds shall be payable exclusively from the fund herein provided therefor from tolls’, section 2, 36 P.S.Pa. 652b; that the Commission shall have the power to enter into contracts, take title to property, employ engineers, architects, inspectors, and attorneys and such other employees ‘as may be necessary in its judgment, and fix their compensation’, #4 (subject to the proviso that all contracts and agreements relating to the construction of the turnpike must be approved by the Department of Highways and the construction shall be under the supervision of the Department of Highways); that, upon completion of the turnpike, the Commission shall fix the amount of the tolls and employ men to collect them and provide for the maintenance of the turnpike; that, upon retire-

ment of the bonds or provision therefor, the Commission shall be dissolved and the turnpike shall become a part of the system of state highways.

From the provisions of the act, as above outlined, it is clear that the Commonwealth of Pennsylvania has so divorced the defendant Commission from the State that this action is one against a legal entity distinct from the State, and the State itself is only indirectly interested in the turnpike.”

It will be noted that the Act of the Pennsylvania Legislature creating the Pennsylvania Turnpike Commission is almost identical with the Act of the Legislature of the State of California creating the California Toll Bridge Authority.

Other cases holding that public corporations such as the California Toll Bridge Authority are separate entities from the state, or government creating them, are the following:

State of Missouri v. Homestead Life Assoc., 90 Fed. (2d) 543.

We quote from page 548:

“Under the Missouri laws the superintendent of the insurance department, is, we think an entity distinct from the state, with power to sue and be sued. The State in the instant action has not made itself ‘an active agent’ and has not ‘assumed responsibility’.

The Missouri Statutes disclaim responsibility in actions of the character of that here involved. They make the officer of the State the active agent * * *. He sues for and recovers in his own name.

Any judgment would be paid to him, and it is not until he collects the judgment that he makes payment to the State Treasurer. * * * The State has divorced itself from the litigation, which the Superintendent of the Insurance Department may conduct. Its position is comparable to that of the beneficiary of an express trust, whose citizenship has no bearing on the jurisdiction of a Federal Court, the Court not looking beyond the citizenship of the trustee, who is the party litigant. The mere fact that the State has a beneficial interest in the ultimate recovery does not make it a party."

In the case of *Sloan Shipyard's Corporation v. United States Shipping Board Emergency Fleet Corporation*, 258 U. S. 549, 66 L. Ed. 762, the Supreme Court held that the corporation was not entitled to the sovereign's immunity from suit brought to compel the rescission of a contract allegedly induced by duress. Likewise, federal corporations have been held liable for damages for actions in tort. *American Cotton Oil Co. v. United States Fleet Corporation*, 270 Fed. 296.

In the case of *Keifer & Keifer v. Reconstruction Finance Corporation*, 306 U. S. 381, 86 L. Ed. 784, a suit for damages for negligence in failing properly to feed livestock entrusted to an agency of the Reconstruction Finance Corporation, to-wit, a Regional Agricultural Credit Corporation, was allowed. This was based on the theory that federal agencies or instrumentalities do not acquire the Government's immunity from suit merely because they do its work and that the mere creation of a federal corporation by

Congress, does not of itself confer upon such corporation legal immunity from suit, even if the conventional "to sue and be sued" clause is omitted in the enumeration of the corporation's powers and functions.

In the recent case of *Reconstruction Finance Corp. v. Minehan Corporation*, 312 U. S. 81, 85 L. Ed. 595, it was held that the Reconstruction Finance Corporation must pay costs when it loses a suit. The Court, speaking through Mr. Chief Justice Hughes, stated:

"The Reconstruction Finance Corporation is a corporate agency of the Government, which is its sole stockholder. It is managed by a Board of Directors appointed by the President, by and with the advice and consent of the Senate. The corporation has wide powers and conducts financial operations on a vast scale. While, as it acts as a governmental agency in performing its functions, still its transactions are akin to those of private enterprise and the mere fact that it is an agency of the Government does not extend to it the immunity of the sovereign. Congress has expressly provided that it shall have power to sue and be sued. There is nothing in the statutes governing its transactions which suggests any intention of Congress that in suing and being sued the corporation should not be subject to the ordinary incident of unsuccessful litigation, in being liable for the costs which might properly be awarded against a private party in a similar case."

Appellant respectfully contends that the Legislature of the State of California in creating the California Toll Bridge Authority, created it as a cor-

poration and a separate entity from the State of California. The decisions we have cited interpreting similar statutes in cases of similar public corporations we respectfully contend support our contention. We also contend that the Federal Court decisions we have cited show that the trend of the law is to hold that governmental corporations, whose funds are distinct from the Government, are separate entities from the governments they represent. If that be so, then the California Toll Bridge Authority is a California corporation and hence a citizen of the State of California (*Barrow Steamship Co. v. Kane*, 170 U. S. 100, 18 S. Ct. 526, 42 L. Ed. 964), and, therefore, there was a diversity of citizenship between the plaintiff and the defendant and hence the Federal Court had jurisdiction of the parties to this action.

Dated, San Francisco,
January 16, 1942.

Respectfully submitted,

DANIEL V. RYAN,

THOMAS C. RYAN,

Attorneys for Appellant.

17
No. 9992

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

CHARLES EVAN FOWLER,

Appellant,

VS.

CALIFORNIA TOLL-BRIDGE AUTHORITY,

Appellee.

BRIEF FOR APPELLEE.

LEO A. CUNNINGHAM,

111 Sutter Street, San Francisco,

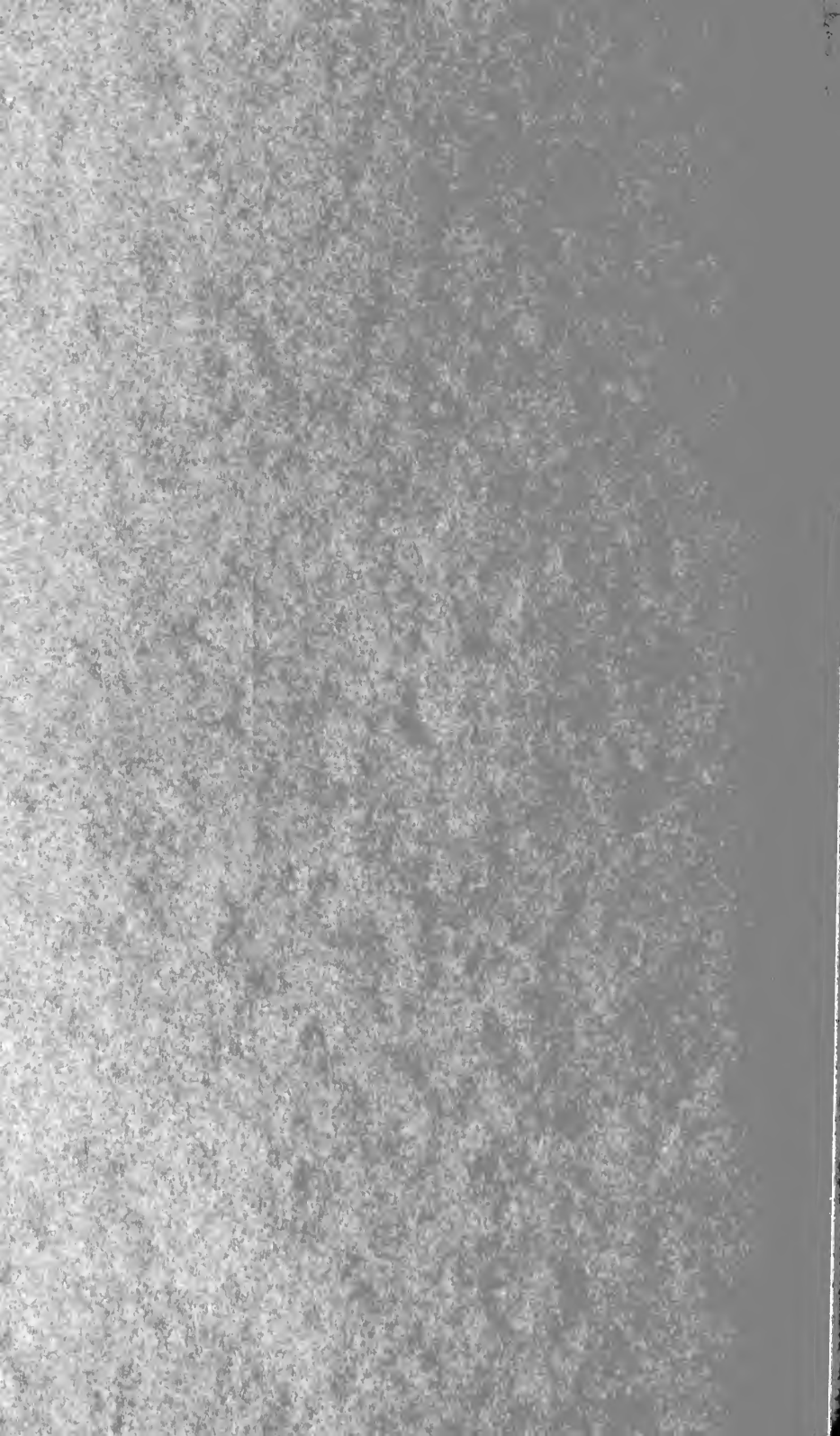
Attorney for Appellee.

FILED

FEB 27 1942

PAUL P. O'BRIEN,

CLERK



Subject Index

	Page
There Can Be No Claim Against the Authority.....	2
Policing and Traffic Regulations of Toll Bridge.....	10
Point 1.	
The authority has no power to construct the bridge.....	11
Point 2.	
Its powers are limited almost exclusively to financing.....	12
Point 3.	
It has no departments to supply plans or specifications.....	13
Point 4.	
None of its officers, agents or employees wrongfully misused plaintiff's property	13
Point 5.	
There is no statutory right in the plaintiff to sue the state or the authority	14
Point 6.	
The misuse, if any, could only have been done by the De- partment of Public Works.....	15
Point 7.	
The state has not given its consent to be sued upon this kind of claim and particularly upon an implied contract'..	15
Point 8.	
The authority can only be sued for a breach of contract or tort arising out of the misuse or non-use of its limited powers	16
Point 9.	
The authority is not a corporation in any unlimited sense...	17
Point 10.	
The authority is a public corporation in a limited sense....	19
Point 11.	
The phrase in the act "may sue or be sued in its own name" has a limitation of meaning.....	26

Table of Authorities Cited

Cases	Pages
Authority v. Kelly, 218 Cal. 7.....	4, 14
Authority v. Wentworth, 212 Cal. 298.....	14
Berryessa v. Sunset Oil Pac. Co., 87 F. (2d) 972.....	16
Bettencourt v. State Accident Commission, 175 Cal. 559, 166 Pac. 323	17
California Toll Bridge Authority v. Kelly, 218 Cal. 7.....	20
California Toll Bridge Authority v. Wentworth, 212 Cal. 298	19
Carver v. Haynes, 37 Fed. Supp. 607.....	22
Chapman v. State, 104 Cal. 690.....	28
Crescent Wharf Co. v. Los Angeles, 207 Cal. 430, 278 Pac. 1028	15, 16
Denning v. State, 123 Cal. 316.....	16, 28
Federal Housing Administration v. Burr, 309 U. S. 245....	23
Gill v. Johnston, 103 Cal. App. 234.....	15
Kansas City Bridge Co. v. Alabama State Bridge Corpora- tion, 59 Fed. (2d) 48 (C.C.A. 5th, 1932).....	24
Keifer & Keifer v. Reconstruction Finance, 306 U. S. 381, 59 Sup. Ct. 516, 83 L. Ed. 784.....	22, 23
Melvin v. State, 121 Cal. 16.....	28
Pacific Fruit Co. v. Oregon Liquor Control, 41 Fed. Supp. 175	23
Pennsylvania Turnpike Cases, 34 Fed. Supp. 26.....	23, 24
State Highway Commission of Arkansas v. Kansas City Bridge Co., 81 Fed. (2d) 689 (C.C.A. 8th, 1936).....	26
Wellsbach v. State of California, 206 Cal. 556.....	14

Codes and Statutes	Pages
Annotation, Vol. 83 Law. Ed., p. 794 at 803.....	22
11 C. J. S., p. 989.....	17
11 C. J. S., p. 990.....	17
6a Cal. Jur. 101-102, par. 33.....	18
23 Cal. Jur. 581.....	28
California Constitution, Article XI, Section 16 $\frac{1}{2}$	20
California Constitution, Article XVI.....	4
California Constitution, Article XX, Section 6.....	27
California Toll-Bridge Authority Act (Chap. 763, Statutes 1929)3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 18, 19	
Political Code:	
Section 363	11, 14, 15
Sections 667, 668	27
Section 688	16, 27, 28
Validating Act of 1939 (Act 8920, Statutes of 1939, Chap. 593)	28
Vehicle Code, Section 400.....	28

No. 9992

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CHARLES EVAN FOWLER,

Appellant,

VS.

CALIFORNIA TOLL-BRIDGE AUTHORITY,

Appellee.

BRIEF FOR APPELLEE.

The appellant specifies three grounds of error. First, that the District Court erred in holding that there was no diversity of citizenship involved. Secondly, that the California Toll-Bridge Authority was in reality the State of California. Third, that the Court did not have jurisdiction over the parties or the subject matter of the cause of action.

Our position is that the District Court was correct in granting our motion to dismiss which is set forth on pages 10 to 18 of the Transcript of Record. We hold that the District Court might have granted our motion on any or all of the grounds which we urged in our memorandum of points and authorities filed with the lower Court.

(Note): Italics ours unless otherwise indicated.

The gist of the amended complaint is that the defendant, California Toll-Bridge Authority (hereinafter referred to as C.T.B.A.), misused the plans and specifications of the plaintiff; that the C.T.B.A. is charged with an appropriation and use of the plans and designs so prepared by the plaintiff; that the Authority used the plans and designs to construct a bridge across the San Francisco Bay and completed it on January 15, 1939. (See Par. V of amended complaint.)

THERE CAN BE NO CLAIM AGAINST THE AUTHORITY.

1. It has no power or authority to acquire or construct a bridge.
2. Its powers are limited almost exclusively to financing.
3. It has no departments or agencies to use the plans or to draft plans or specifications or survey or construct. (Its powers are to direct and authorize the Department of Public Works, which is the State.)
4. None of its officers, agents or employes wrongfully misused plaintiff's plans or designs since it has none.
5. There is no statutory right in favor of the plaintiff to sue the Authority.
6. The misuse, if any, could only have been done by the Department of Public Works of the State of California.

7. The State has not given its consent to be sued upon this kind of claim and particularly upon an implied contract.
8. The Authority can only be sued for a violation of a contract or tort arising out of the misuse or non-use of its limited powers.
9. The Authority is not a corporation in an unlimited sense.
10. The phrase in the Act "may sue or be sued in its own name" has a limitation of meaning.

To understand the full and complete nature of what the C.T.B.A. is, the statute itself must be read carefully. The following is a digest of it:

California Toll-Bridge Authority Act.

Enacted by Chap. 763, Statutes 1929.

Sct. 1. *It is hereby declared to be the policy of the State of California to acquire and own all toll bridges situated upon or along any part of the highways of the State, with the end in view of ultimately eliminating all toll charges thereon.*

Sct. 3. There is hereby created a board to be known as C.T.B.A., composed of the Governor, etc.
* * * shall serve without compensation * * *
may sue and be sued in the name of the C.T.B.A.

Sct. 4. The C.T.B.A. shall authorize and direct the Department of Public Works to build toll bridges and other toll highway crossings and

to acquire for and in the name of the State of California toll bridges, etc. * * *

Sct. 5. * * * All such bonds so authorized shall be issued in the name of said C.T.B.A. * * * and that neither the payment of the principal or any part thereof or any interest thereon constitutes a debt, liability or obligation of the State of California.

(This provision is inserted to avoid the effect of Const. prohibitions of creating debt against the State. See Const. Art. XVI. See *Authority v. Kelly*, 218 Cal. 7.)

Amended by Chap. 486, Statutes 1937.

Sct. 6. * * * The C.T.B.A. may contract loans and borrow money through the sale of bonds. * * *

Amended by Chap. 10, Statutes 1933.

Sct. 6.8. * * * The C.T.B.A. may from time to time, upon such terms and conditions in all respects as it may approve and consistently with the provisions of this Act, enter into indentures or agreements containing etc. (Agreements relative to bonds.)

Sct. 6.9. All bonds and income * * * shall be exempt from taxation, except for transfer, inheritance and estate taxes.

Added by Chap. 486, Statutes 1937.

Sct. 7. The C.T.B.A. is hereby empowered to fix the rates of toll and other charges. * * *

Amended by Chap. 10, Statutes 1933.

Sct. 8. The Department of Public Works shall have *full charge of the acquisition and construction* of all such toll bridges and other highway crossings as may be authorized by the C.T.B.A., the operation and maintenance thereof and the collection of tolls thereon. * * *

Chap. 10, Statutes 1933.

Sct. 8½. *The Department of Public Works shall have full charge of the acquisition and construction* of all transportation facilities which may be authorized by the C.T.B.A. * * *

Chap. 288, Statutes 1935.

Sct. 9. The Department of Public Works is hereby authorized and empowered to condemn and take, in fee or otherwise as the C.T.B.A. may determine in the name of the State of California. * * * (It) shall not have the power to commence any such proceedings in eminent domain unless and until the C.T.B.A. shall first have passed a resolution declaring that public interest and necessity require. * * * When the State or any department or governmental agency thereof acquires any existing toll bridge or the real or personal property used in connection therewith, said property shall continue to be subject to taxation by the county, etc. * * *

Chap. 228, Statutes 1935.

Sct. 9½. The Department of Public Works is hereby authorized and empowered to condemn and take, in fee or otherwise, as the C.T.B.A. may determine, in the name of the State of Cali-

fornia, any transportation facilities authorized to be constructed or acquired pursuant to Section 5½ hereof, of any toll bridge or bridges * * * under the provisions of this Act. * * *

Sct. 9¾. The Department of Public Works is hereby authorized and empowered to condemn, possess and take, in fee or otherwise as the C.T.B.A. may determine, in the name of the State of California * * *.

Chap. 228, Statutes 1935.

Sct. 9.8. The Department of Public Works is hereby authorized and empowered to condemn and take in fee or otherwise as the C.T.B.A. may determine in the name of the State of California * * * any real property (for exchange purposes).

Chap. 486, Statutes 1937.

Sct. 11. * * * The C.T.B.A. may enter into a binding agreement with any city, county, etc * * * to repay any money or value of any rights of way * * *.

Chap. 228, Statutes 1935.

Sct. 13. The proceeds from the sale of all bonds authorized under the provisions of this Act shall be paid to the State Treasurer for the credit of the C.T.B.A. * * * and the C.T.B.A. may agree with the purchaser of said bonds upon any conditions or limitations restricting the disbursements of such funds. * * *

All tolls or other revenue * * * shall be paid over by the Department of Public Works at least monthly to the State Treasurer. * * *

Warrants for payments to be made on account of such bonds shall be drawn by the State Controller upon request of the State Treasurer. * * *

Amended by Chap. 486, Statutes 1937.

Sct. 13½. Any provisions * * * Authorizing the issue of bonds * * * shall constitute a contract with the holders of said bonds and be binding upon the C.T.B.A. as long as said bonds may be outstanding.

Chap. 10, Statutes 1933.

Sct. 14. Nothing in this Act shall be construed to prevent the State from making appropriations from time to time. * * *

Chap. 228, Statutes 1935.

Sct. 16. The C.T.B.A. is hereby authorized and empowered to prescribe the terms and conditions * * * (of transportation) * * * is further authorized to grant permits to and enter into contracts with steam, electric, bus, railroad and other transportation companies * * * (it) shall first determine that such permit or contract is advisable or necessary. * * *

Chap. 228, Statutes 1935.

Sct. 16¼. The C.T.B.A. is hereby authorized and empowered to prescribe the terms and conditions upon which any person or firm * * * may

transport any person or property over the additional transportation facilities * * * (it) is hereby further authorized and empowered to contract with respect to the use and operation of such additional transportation facilities. * * *

Chap. 228, Statutes 1935.

Sct. 161½. * * * The C.T.B.A. is authorized and empowered, in behalf of the State of California * * * to operate the transportation facilities of any toll bridge. * * *

Sct. 17. *The Department of Public Works, through its own engineers * * * shall design all bridges to be built under the Authority of this Act.* * * *

Chap. 10, Statutes 1933.

Sct. 18. The C.T.B.A. may authorize the Department of Public Works to acquire * * * tubes and tunnels. * * *

Chap. 763, Statutes 1929.

Sct. 19. When any such toll bridge or bridges * * * is being built by the Department of Public Works, the said Department and/or the C.T.B.A. may carry or cause to be carried such an amount of insurance, etc., as protection against loss or damage as the C.T.B.A. may deem proper. (Casualty Insurance.)

Chap. 10, Statutes 1933.

Sct. 221½. The C.T.B.A. * * * are empowered to do such acts * * * regarding the construction,

maintenance, operation and insurance of such toll bridges * * * (Power of disposal of property or dedicate to public use.) * * * *Any agreement or lease or conveyance herein authorized shall be executed or accepted on behalf of the State of California by the Director of the Department of Public Works.*

Chap. 486, Statutes 1937.

Chap. 24, Statutes 1933, provides authority to C.T.B.A. to fix and collect tolls on the bridge to be constructed from San Francisco to the County of Alameda and repay to the State certain funds advanced to the Authority.

Chap. 5, Statutes 1933.

For the purpose of enabling the Department of Public Works to construct the approaches to a toll bridge to be built over the bay of San Francisco from the City and County of San Francisco to the County of Alameda * * * to acquire all lands, etc. * * * there is hereby appropriated out of any moneys to accrue or be credited to said fund * * * the sum of \$1,650,000 etc. Chap. 6, Statutes 1933. * * * The C.T.B.A. shall pay into the general fund in the State Treasury from the proceeds of the first sale of revenue bonds a sum not in excess of \$65,000.

Chap. 9, Statutes 1933, is an Act directing the Department of Public Works to construct the approaches of S.F.-O.B.B. and requiring their maintenance.

Sct. 3 thereof—The toll bridge and the approaches to it herein directed to be constructed shall be and constitute a primary State Highway and the said toll bridge and structure on the approaches thereto shall at all times during construction be insured against all risks to the *full insurable value thereof for the protection of the State of California.* * * *

Sct. 4. As long as the bonds are outstanding the completed bridge and approaches * * * the Department of Public Works shall permanently maintain and operate the said toll bridge approaches. * * *

POLICING AND TRAFFIC REGULATIONS OF TOLL BRIDGE.

(Provisions of Vehicle Code, State of California.)

Division IXa—vehicular crossing.

Chapter 1—Definitions and general provisions.

605 (a) vehicular crossing means and includes every toll bridge and toll highway crossing and the approaches thereto, *constructed or acquired by the Department of Public Works* under the provisions of the C.T.B.A. Act.

Chap. 847, Statutes 1935.

POINT 1.

THE AUTHORITY HAS NO POWER TO CONSTRUCT
THE BRIDGE.

The building and construction of the bridge is in the Department of Public Works.

See

Sct. 4, Chap. 763, Statutes 1929;

Sct. 8, Chap. 10, Statutes 1933;

Sct. 8½, Chap. 288, Statutes 1935.

It has no power to design or build a bridge.

See Sct. 17, Chap. 10, Statutes 1933, reading, "The Department of Public Works, through its *own engineers* or through such other engineers or experts it may employ, *shall design all bridges* * * *."

All the powers of engineering, the designing, the surveying, the planning as well as construction are not placed in the Authority but by its direction is performed by the Department of Public Works. The Department of Public Works is not a separate entity such as is the Authority, but it is a department of the State and all of its agents, servants and employes are such of the State. The Authority does not survey, lay out or design bridges or approaches; they are surveyed, laid out and designed by the Department of Public Works, which, of course, legally is one and the same thing as the State.

(Toll Bridge Act, Scts. 4, 5, 8, 17 and Pol. Code Sct. 363.)

POINT 2.

ITS POWERS ARE LIMITED ALMOST EXCLUSIVELY
TO FINANCING.

See

Sct. 5, Act 763, Amended Chap. 486, Statutes 1937;

Sct. 5 $\frac{1}{2}$, Enacted by Chap. 228, Statutes 1935;

Sct. 5 $\frac{3}{4}$, Enacted by Chap. 228, Statutes 1935;

Sct. 6, Act 763, Amended Chap. 10, Statutes 1933;

Sct. 6 $\frac{3}{4}$, Act 763, Added by Chap. 486, Statutes 1937;

Sct. 6.8, Act 763, Added by Chap. 486, Statutes 1937;

Sct. 6.9, Act 763, Added by Chap. 486, Statutes 1937;

Sct. 7, Act 763, Amended Chap. 10, Statutes 1933;

Sct. 10, Act 763, Amended Chap. 10, Statutes 1933;

Sct. 11, Act 763, Amended Chap. 228, Statutes 1935;

Sct. 13, Act 763, Amended Chap. 486, Statutes 1937;

Sct. 13 $\frac{3}{4}$, Enacted by Chap. 228, Statutes 1935;

Sct. 22 $\frac{3}{4}$, Enacted by Chap. 10, Statutes 1933.

POINT 3.

IT HAS NO DEPARTMENTS TO SUPPLY PLANS OR SPECIFICATIONS.

Sct. 17, Act 763, Amended Chap. 10, Statutes 1933.

POINT 4.

NONE OF ITS OFFICERS, AGENTS OR EMPLOYES WRONGFULLY MISUSED PLAINTIFF'S PROPERTY.

Certain officers of the State comprise the members of the Authority. They may employ a secretary and such persons as may be necessary to perform its duties. Among its enumerated duties it is not required to build, acquire or construct the San Francisco-Oakland Bay Bridge, nor could it use any plans or drawings. This power lies with the Department of Public Works.

Sct. 3, Act 763, Amended Chap. 401, Statutes 1931;

Sct. 81½, Act 763, Enacted Chap. 228, Statutes 1935;

Sct. 17, Act 763, Amended Chap. 10, Statutes 1933.

Sct. 19, Act 763, Amended Chap. 10, Statutes 1933.

POINT 5.

THERE IS NO STATUTORY RIGHT IN THE PLAINTIFF TO
SUE THE STATE OR THE AUTHORITY.

As stated in *Authority v. Wentworth*, 212 Cal. 298, the statute creates "a public agency of the State" and further, "merely creates a subordinate administrative body to carry out a declared legislative purpose". In *Authority v. Kelly*, 218 Cal. 7, it is said, "Authority is a separate corporation and agency of the State."

The Authority proceeds in the name of and acts for the State of California. The language of the Act indicates that the Authority as a separate entity does not do any of the acts or things which the Department of Public Works does. If the acts of the Department of Public Works are performed as directed by the Authority, since the latter is a department of the State (Pol. Code 363), the injury complained of was done by the State and not by the Authority. There could not be a misuse of the plans because the Authority had no power to use them. And as a matter of fact it is common knowledge as well as judicial knowledge that the bridge was built by the Department of Public Works and not by the C.T.B.A. If the Authority through its members or secretary misappropriated the plans there is no liability. State officers and agencies when acting in such official capacity do not incur separate liability and if any wrongful act is done in the performance of such duties that act is the liability of the State itself.

Wellsbach v. State of California, 206 Cal. 556
at 561.

POINT 6.

**THE MISUSE, IF ANY, COULD ONLY HAVE BEEN DONE
BY THE DEPARTMENT OF PUBLIC WORKS.**

If there was misuse of the plans and designs as contended, it could not have been done by the defendant. Its powers give it no facilities to make use of any such wrongful appropriation. If the act of pilfering was done by the defendant, it had no facilities to make use of the plans. The only agency which could have utilized the plans must have been the Department of Public Works. The Department of Public Works was and is the State of California.

(Pol. Code 363.)

 POINT 7.

**THE STATE HAS NOT GIVEN ITS CONSENT TO BE SUED UPON
THIS KIND OF CLAIM AND PARTICULARLY UPON AN IM-
PLIED CONTRACT.**

If our contention raised in Point 6 be sound, it must follow that the liability reposes against the State.

It is fundamental that the State may not be sued without its consent.

Gill v. Johnston, 103 Cal. App. 234.

Should consent be given, it may be sued only on the conditions provided by statute.

Crescent Wharf Co. v. Los Angeles, 207 Cal. 430, 278 Pac. 1028.

We urge that the State is the real party in interest in this suit and it may be sued only if it has con-

sented so to be. The only statute consenting to suit is Sec. 688 of the Political Code. It permits actions only upon express contracts or for negligence. It does not create a liability where none exists under some other statute or law but confers only an additional remedy to enforce such otherwise existing liability.

Denning v. State, 123 Cal. 316.

A cause of action for damages arising out of a public work arises upon implied contract.

Crescent Wharf Co. v. Los Angeles, 207 Cal. 430.

In *Berryessa v. Sunset Oil Pac. Co.*, 87 F. (2d) 972, it is held that the State has not given its consent to be sued upon an implied contract. The consent must be clear and definite.

POINT 8.

THE AUTHORITY CAN ONLY BE SUED FOR A BREACH OF CONTRACT OR TORT ARISING OUT OF THE MISUSE OR NON-USE OF ITS LIMITED POWERS.

The liability generally of a corporation is that confined within the scope of its powers. Since the Authority is an entity created by statute it can only be liable for those acts which arise out of or within its functions. If this were a suit for a breach of contract made with its bondholders under its bond indenture it could be sued in its own name for a cause of action created by it. Or, if the Authority violated any lease agreements made by it, it could

be sued. The obligation sought to be established by this amended complaint is clearly outside the scope of defendant's authority.

The C.T.B.A. came into being by statute of 1929. The plans said to be misused were first in existence in 1915.

“The state is as a general rule the source of authority as respects the building of public bridges. * * * The state may exercise its powers directly or may delegate it to governmental agencies.”

11 *C. J. S.*, p. 989.

The powers of a commission for bridge purposes are dependent upon statute creating it.

11 *C. J. S.*, p. 990.

POINT 9.

THE AUTHORITY IS NOT A CORPORATION IN ANY UNLIMITED SENSE.

“Corporations are either public or private. Public corporations are formed or organized for the government of a portion of the State; all other corporations are private.”

This is a statement of the general rule.

“Public corporations under the controlling definition of law are those formed for political and governmental purposes and are vested with political and governmental powers.”

Bettencourt v. State Accident Commission, 175
Cal. 559, 166 Pac. 323.

“Such (Public) corporations are auxiliaries of the government in the important business of municipal rule and their leading object is to promote the public interest. They are public corporations if they possess the attributes thereof, even though the organic statute does not call them corporations.”

6a *Cal. Jur.*, pp. 101-102, par. 33.

The Authority is a public corporation in the sense that it is an auxiliary of the State and from a study of Chapter 763 as amended, its sole purpose and reason for existence was and is to finance the construction of the San Francisco-Oakland Bay Bridge in particular and toll bridges in general. In the enactment of Chapter 763 the policy of the State is to acquire and own all toll bridges to the end of making them free of toll charges. (Sct. 1 of the Act.) The acquisition of property, condemnation proceedings, plans, specifications for building, construction, all such obligations by the Act are vested in the Department of Public Works of the State of California subject to the approval and direction of the C.T.B.A.

It is clear from a reading of the Act that all necessary powers were vested in the Authority by the legislature to establish the necessary financing of the bridge which was specifically intended to be built by the State through its Department of Public Works.

The powers to construct are found in:

Sct. 4, Act 763, Statutes 1929;

Sct. 8, Act 763, Chap. 10, Statutes 1933;

Sct. 8½, Act 763, Chap. 288, Statutes 1935.

The powers to finance are found in:

Scts. 5, 5 $\frac{1}{2}$, 5 $\frac{3}{4}$, 6, 6 $\frac{1}{2}$, 6 $\frac{3}{4}$, 6.8, 7, 10, 11, 13,
13 $\frac{1}{2}$, Statutes 1929, 1933, 1935, 1937.

The general powers are found in:

Sct. 22 $\frac{1}{2}$, Chap. 486, Statutes 1937.

POINT 10.

THE AUTHORITY IS A PUBLIC CORPORATION IN A LIMITED SENSE.

The nature of the authority has been passed upon in two cases by the Supreme Court of the State of California. In *C.T.B.A. v. Wentworth*, 212 Cal. 298:

“The State of California may make appropriations for preliminary expenses necessary for the building or acquiring of any toll-bridge. (Section 14.)

Prior to entering into any contract or granting any permit for the use of any toll-bridge, the Authority must first determine that such an agreement will be for the best interests of the State of California. (Section 16.)

All leases and conveyances connected with bridge operations are to be executed by the Director of the Department of Public Works on behalf of the State of California. (Section 22 $\frac{1}{2}$.)”

In *California Toll Bridge Authority v. Wentworth* (supra), the Court was concerned with legality of an appropriation by the Board of Supervisors of the City and County of San Francisco to the Cali-

fornia Toll Bridge Authority to meet the necessary costs of preparing the surveys and plans for the Bay Bridge. The contention was advanced that the Toll Bridge Authority Act was unconstitutional as an attempt by the legislature to delegate the right to pledge earnings and revenues from State property without the approval of the legislature or the voters of the State. The Court stated that the Act did not have this effect because:

“The Act creating the Toll Bridge Authority, and providing for the cost of the construction of toll bridges through the revenue-bonds method of financing, pledges the earnings and revenue derived from the bridge when erected, as security for the payment of the bonds, without any liability resting on the state, *and merely creates a subordinate administrative body to carry out a declared legislative purpose.*”

In *California Toll Bridge Authority v. Kelly*, 218 Cal. 7, which was a proceeding in mandamus to force the Director of Public Works of the State of California to sign the bonds issued by the Authority, the contention was made that the Toll Bridge Authority could not deposit its funds outside of the State of California for the payment of bond interest because it was not specifically mentioned in Article XI, Section 16½ of the California Constitution. This section provides that “the State * * * or other public or municipal corporation * * * may deposit moneys in any bank or banks outside this State * * *.” The Court held that the Authority would have this power because it was an agency of the State, and said:

*“There can be little question that the California Toll Bridge Authority is an agency of the State. Consequently, all moneys received from the sale of bonds and other tolls and from revenues of the bridge are in the custody of the state. Furthermore, while there is no express reference to the Bridge Authority as being a public corporation, we are satisfied that it is * * *. Where a corporation is composed exclusively of officers of the government having no personal interest in it or with its concerns, and only acting as the organs of the state in effecting a great public improvement, it is a public corporation.”*

The fact that the Authority may be a public corporation does not ipso facto establish diversity of citizenship.

The appellant seems to contend that merely because the C.T.B.A. is a public corporation, it is a citizen of the State of California, and therefore, the Federal Court has jurisdiction on grounds of diversity of citizenship. It is apparent that in making this contention, they assume the answer to the whole problem. We do not contend that the C.T.B.A. is not a public corporation. Our position is, that it is a State agency acting as an arm of the State in carrying out a great public purpose. It is an agency created to serve a governmental necessity and is not functioning in a proprietary capacity in competition with private industry or business. It is not operated to make profit for itself, or its officers or the State. It is a legal instrument to free the State from creating indebted-

ness in order to serve the public in the building and operation of State highways.

“It has been held, however, that corporations performing what are essentially public or governmental functions are in effect part of the government, that actions against such corporations are in effect against the government, and that, in the absence of the sovereign’s consent to suit, *they cannot be sued.*”

It has always been recognized that the sovereign may create corporate agencies as appropriate means of exercising the powers of government.

Keifer & Keifer v. Reconstruction Finance,
306 U. S. 381, 59 Sup. Ct. 516, 83 L. Ed. 784.

See Annotation, Vol. 83 Law Ed., p. 794 at 803
and cases cited.

From an analysis of the above cited annotation it appears that the recent trend of the Federal decisions (as is apparent in the *Keifer* case), seek to deny immunity to suit to most agencies created by Congress. But, the established rules upon this point have not been altered unless the State agency functions in a field apart from governmental service.

The rules for testing the granting or withholding of immunity from suit to a State agency are set forth in the above annotation, page 803 of 83 L. Ed. to page 806.

There is also an adequate review of the recent decisions on the question of suability in *Carver v. Haynes*, 37 Fed. Supp. 607.

The District Court of Oregon held recently in *Pacific Fruit Co. v. Oregon Liquor Control*, 41 Fed. Supp. p. 175, that the test to determine whether a suit is actually brought against the State, so as to require consent of the State to be sued, is contained in the question of *where the weight of judgment if rendered will fall*.

The points urged in the Oregon case are almost identical to our present problem. Appellant places the weight of his position upon the *Keifer* case (supra) and *Pennsylvania Turnpike* case, 34 Fed. Supp. 26. Both of these cases are distinguishable. First, the *Keifer* case, cited with approval in 84 L. Ed. 725, *Federal Housing Administration v. Burr* at page 728 (309 U. S. 245), sets forth the recent doctrine of liberal construction on the right to sue the Federal government. The feature to keep in mind, however, is the construction given by Federal Courts to Federal agencies is not the same doctrine which must apply to a State statute which organizes a State agency. The statutes of California and the cases of the California Supreme Court are not as liberal as Federal principles. Since the C.T.B.A. is an instrument of the State, it is our opinion that the appellant is misleading himself in reliance upon the *Keifer* case to support his contention.

The *Pennsylvania Turnpike* case was determined by the contents and the language of the statute which brought this commission into being. A comparison of the Pennsylvania Act differs widely from the provision of the California statute. It is our opinion

that the *Turnpike* case is not in point. The other cases cited in their brief announce general rules which throw no light upon the determination of this controversy.

Most of the powers given the Pennsylvania Commission are withheld by the California statute and these omitted powers are placed in the Department of Public Works of the State of California.

Important aspects of the question to be decided, is whether or not the C.T.B.A. is so close to the State of California in its origin, functions and purposes, that it must be reviewed as if the State were the nominal party, as well as the real party in interest.

A case on all fours with the present case is *Kansas City Bridge Co. v. Alabama State Bridge Corporation*, 59 Fed. (2d) 48 (C.C.A. 5th, 1932). The question involved is whether or not a suit against the Alabama State Bridge Corporation was in reality a suit against the State of Alabama and therefore not maintainable, since the State cannot be sued. The statute creating the bridge corporation was almost identical with the California Toll Bridge Authority Act. Its officers were State officers. The tolls collected from the operation of the bridge were to be paid into the State Treasury and kept in a separate fund by the State Treasurer for the retirement of bonds. The officers received no compensation in addition to their salaries in their other State capacities. There was a provision that the corporation could sue and be sued. The Court held that the suit was in reality against the State, stating:

"It is clear that the whole purpose of the act was to erect bridges essential to the highway system, to pay for them with tolls, and then to make them free for the use of the public. It is well settled that the construction of public roads and bridges is a governmental function. Dodge County Commissioners v. Chandler, 96 U. S. 205, 24 L. Ed. 625; Atkin v. Kansas, 191 U. S. 207, 24 S. Ct. 124, 48 L. Ed. 148; 1 Bl. Com. 357; 13 R. C. L. 79. The state may either perform this function in its own name or through its public officers or one of its governmental agencies. Fitts v. McGhee, 172 U. S. 516, 19 S. Ct. 269, 43 L. Ed. 535; Atkin v. Kansas, supra. The Alabama Bridge Corporation was but an agency or instrumentality through which the state acted in causing its public bridges to be constructed. It was not a private corporation in any sense of the word, but state officials, who might as well have been designated a board or commission, were ex officio members, and the only members, of it. Alabama State Bridge Corp. v. Smith, supra; Clallam County, Wash. v. United States, 263 U. S. 341, 44 S. Ct. 121, 68 L. Ed. 328. In the nature of things the state had to choose some such agency in order to effectuate its purpose. Lane v. Minnesota State Agricultural Society, 62 Minn. 175, 64 N. W. 382, 29 L. R. A. 708. The state itself is directly concerned in the construction and maintenance of public roads and bridges, in the same way that it is in its public school system in the maintenance of which it hardly will be doubted that it is performing a governmental function. Alabama Girls' Industrial School v. Reynolds, 143 Ala. 579, 42 So. 114. Its interest is different from that which it has in its railroad

commission, or governmental subdivisions, such as counties and municipalities, which are given many powers of their own, private as well as governmental. 'It is not enough that the state should have a mere interest in the vindication of her laws, or in their enforcement as affecting the public at large, or as they affect the rights of individuals or corporations, but it must be an interest of value to herself as a distinct entity.' *Railroad Commissioners v. P. & A. R. R. Co.*, 24 Fla. 417, 464, 5 So. 129, 133, 2 L. R. A. 504, 12 Am. St. Rep. 220."

In the case of *State Highway Commission of Arkansas v. Kansas City Bridge Co.*, 81 Fed. (2d) 689, (C.C.A. 8th, 1936), the defendant Highway Commission was sued in the Federal Court on grounds of diversity of citizenship. The Circuit Court of Appeals dismissed the case for lack of jurisdiction because the suit was in reality against the State of Arkansas.

POINT 11.

THE PHRASE IN THE ACT "MAY SUE OR BE SUED IN ITS OWN NAME" HAS A LIMITATION OF MEANING.

The Toll Bridge Act and the provisions of the Political Code with respect to the Department of Public Works and with respect to the liability of the Authority or the State must be construed as a whole, and if any parts of the whole be inconsistent,

these parts must be reconciled. We know of no inconsistencies.

Chap. 736 as Amended, Sets. 667, 668 and 688
of Pol. Code of State of California;
Const. Art. XX, Sect. 6 of California.

It seems plain that a proper construction of the Toll Bridge Act results in the conclusion that the California Toll Bridge Authority exercises certain specific functions, as stated in the Act and that the Department of Public Works, acting as a State Department and for and in the name of the State, does certain other acts, among which is the actual planning and constructing of toll bridges and the acquisition of properties necessary therefor. Everything that is done is done for the State. If a liability exists it will be paid out of the State Treasury and by the State when and if the legislature makes an appropriation for the purpose. Therefore, it would appear that the reference to suits in the Toll Bridge Act must be limited to such suits as pertain to the limited functions which the Authority exercises. It is submitted that if any liability exists it is a liability of the State, that the Political Code applies, that consent to such suit has not been given by the sovereign State and that the reference to suits in the Toll Bridge Act pertains to suits of an entirely different nature.

“It is fundamental that the State can be sued only in those cases as to which the legislature has granted permission.”

Section 6 of Article XX of the Constitution reads as follows:

“Suits may be brought against the State in such manner and in such courts as shall be directed by law.”

Section 688 of the Political Code is the only general statute which has been enacted by the legislature authorizing suits against the State. There are some special statutes authorizing actions against the State to quiet title and to recover taxes illegally paid, but Section 688 is the only general statute which permits it.

This section of the Political Code authorizes suits against the State only in two situations: first, suits on express contract, and, second, suits for negligence.

The Courts have held that as to negligence, Section 688 authorizes suits only where other provisions of law impose a liability upon the State. The section gives a remedy when a liability exists, but of itself creates no liability. The only liability for negligence which has been created against the State is that involving the use of motor vehicles under Section 400 of the Vehicle Code.

23 Cal. Jur. 581;

Denning v. State, 123 Cal. 316;

Melvin v. State, 121 Cal. 16;

Chapman v. State, 104 Cal. 690.

The complaint in this action alleges neither express contract nor negligence.

We wish to call the Court's attention to the Validating Act of 1939. (Act 8920, Statutes of 1939, Chap. 593.) It defines the term “public body”, enumerates

many of them and among the last listed is the California Toll Bridge Authority. It is clear then that the legislature established the Authority as a public body to serve the State of California.

We respectfully submit that the lower Court was correct in granting our motion to dismiss.

Dated, San Francisco,

February 25, 1942.

LEO A. CUNNINGHAM,

Attorney for Appellee.



No. 9992

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

CHARLES EVAN FOWLER,

Appellant,

VS.

CALIFORNIA TOLL-BRIDGE AUTHORITY,

Appellee.

APPELLANT'S REPLY BRIEF.

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Subject Index

	Page
I. State funds were not used in the construction of the Bay Bridge	1
II. The California Toll Bridge Authority was created as a corporation and a separate entity from the state.....	5
III. The Department of Public Works was the agent of the Toll Bridge Authority in the construction of the bridge	11

Table of Authorities Cited

Cases	Pages
Annotations, 306 U. S. 398, 83 L. Ed. 794.....	8, 9
Barrow Steamship Co. v. Kane, 170 U. S. 100, 18 S. Ct. 526, 42 L. Ed. 964.....	14
Biederman v. Home Owners Loan Corporation, 208 Fed. Sup. 23	9
California Toll Bridge Authority v. Kelly, 218 Cal. 7.....	5
Federal Housing Administration v. Burr, 309 U. S. 242, 84 L. Ed. 724	10
Hunkin-Conkey Construction Co. v. Pennsylvania Turnpike Commission, 34 Fed. Sup. 26.....	4, 10, 14
Kansas City Bridge Co. v. Alabama State Bridge Corp., 59 Fed. 2d 48	2
Keifer v. Reconstruction Finance Corp., 306 U. S. 387, 83 L. Ed. 784	9
Louisiana Highway Commission v. Farnsworth, 74 Fed. 2d 910	7, 8
Pacific Fruit Company v. Oregon Liquor Commission, 41 Fed. Sup. 175	10
State of Missouri v. Homestead Life Association, 90 Fed. 2d 543	14
State Highway Commission of Arkansas v. Kansas City Bridge Co., 81 Fed. 2d 689.....	2, 7
State Highway Commission of Wyoming v. Utah Construc- tion Company, 278 U. S. 194, 49 S. Ct. 104, 73 L. Ed. 262	4
Tompkins v. Kanawaha Board, 19 W. Va. 257.....	8

Statutes

California Statutes of 1929, page 1489, Deering's General Laws of the State of California, Act 956.....	3
--	---

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Appellee.

APPELLANT'S REPLY BRIEF.

I.

**STATE FUNDS WERE NOT USED IN THE CONSTRUCTION OF
THE BAY BRIDGE.**

The appellee in his brief has not controverted the statement of the case set forth in appellant's brief; therefore, it is agreed by the parties that the main issue is still whether the appellee is a separate entity from the State of California or whether it is actually the State of California. On the decision of this issue depends the answer to the question whether there was a diversity of citizenship between the parties hereto.

Appellant relies on two cases as authority for its contention that the appellee is not a separate entity from the state but is in reality the State of California.

They are: *Kansas City Bridge Company v. Alabama Bridge Corporation*, 59 Fed. (2d) 48 and *State Highway Commission of Arkansas v. Kansas City Bridge Company*, 81 Fed. (2d) 689. Appellant respectfully contends that the factual situation in said cases materially differs from the factual situation existing in our case because the funds used to build the bridges in both instances were funds of the state and not of the bridge corporation. We quote from page 49 of the first mentioned case:

“For the purpose of providing funds for building bridges, the corporation is authorized to borrow money by issuing bonds, which are to be attested by the Secretary of State and approved by the Governor. The interest on the bonds which are declared to be tax free, may be paid out of state funds derived from the gasoline tax or from the state convict fund.”

In regard to the second of said cases, the State Highway Commission of Arkansas had no funds of its own. We quote from page 690 of said case:

“The revenues available for meeting obligations incurred by that commission were State revenues.”

We further quote:

“Moreover, the purpose of this suit was to require the *State* to make pecuniary satisfaction for a liability which, it has been held, would make the suit one against the State.”

In our case, state funds were not used in building the bridge. We quote from Section 4 of the Cali-

California Toll Bridge Authority Act (Statutes 1929, page 1489, Act 956, Deering's General Laws of California):

“* * * and to pay for the same (the construction of the bridge) out of any fund or funds provided or made available by this act.”

Section 5. “All such bonds so authorized shall be issued in the name of the California Toll Bridge Authority and shall constitute obligations only of said California Toll Bridge Authority and shall be identified as toll bridge bonds and shall contain a recital on the face thereof that the payment or redemption of said bonds and the payment of the interest thereon is secured by a direct and exclusive charge and lien upon the tolls and other revenues of any nature whatever received from the operation of the particular toll bridge or bridges or other highway crossings for the acquisition or construction of which the bonds are issued and that neither the payment of the principal or any part thereof or any interest thereon constitutes a debt, liability or obligation of the State of California.”

Section 5½ contains similar provisions in regard to bonds for obtaining funds to provide transportation facilities on the bridge. Section 5¾ contains similar provisions in regard to bonds for additional facilities. Section 6 contains provisions in regard to the issuance of the bonds, the form thereof and the execution and sale of said bonds.

Section 10 of said act provides:

“Bonds issued under the provisions of this Act shall not constitute or be a debt, liability or ob-

ligation of the state, and the payment of both principal and interest of all such bonds shall be secured only by the tolls or other revenues collected from the particular toll bridge or bridges or other highway crossings for which such bonds were issued, and other revenues and interest thereon and sinking funds created therefrom, received by the California Toll Bridge Authority, and shall be paid from such tolls or revenues or from such other contributions or appropriations as may be made available under the terms of this act."

The distinction between our case and the two Kansas City Bridge Company cases, above mentioned, is that in said cases state funds were used in the construction of the bridges, whereas in our case funds of the California Toll Bridge Authority were used. That same distinction is the basis of the difference in the authorities between the cases holding that the state is the real party in interest and those holding that the governmental agency is the real party in interest. That distinction is pointed out by the District Court of Pennsylvania in the case of *Hunkin-Conkey Construction Company v. Pennsylvania Turnpike Commission*, 34 Fed. Sup. 26, 29, cited in our opening brief at page 5 as the basis of its analysis of the various cases which the Court has analyzed. We quote therefrom:

"This case is clearly distinguishable from the case of *State Highway Commission of Wyoming v. Utah Construction Company*, 278 U. S. 194, 49 S. Ct. 104, 73 L. Ed. 262. There, the construction contract was entered into in the name of the

state; the Commission did not have any funds of its own but received its funds from the State; the State alone would have been compelled to respond in damages in event of liability to the contractor. The only conclusion possible under such circumstances was that the State was the real party defendant.

In the case of *Kansas City Bridge Co. v. Alabama State Bridge Corp.*, 5 Cir., 59 F. 2d 48, the State again supplied the funds to be used by the Bridge Corporation in the construction of the bridges and, in addition, the officers of the Bridge Corporation were officials of the State who acted without compensation in addition to their official salaries.

State Highway Commission v. Kansas City Bridge Co., 8 Cir., 81 F. 2d 689, is also a case in which the State was directly responsible for the liability which the suit was brought to establish, as the Commission had no funds of its own from which the damages could be paid."

II.

THE CALIFORNIA TOLL BRIDGE AUTHORITY WAS CREATED AS A CORPORATION AND A SEPARATE ENTITY FROM THE STATE.

Appellee concedes in its brief that the California Toll Bridge Authority is a corporation. (See page 21.) It was declared to be a public corporation by the Supreme Court of California in the case of *California Toll Bridge Authority v. Kelly*, 218 Cal. 7. As indicative of the fact that this corporation is a separate entity from the State of California, aside

from the fact that it is self-supporting and has its own funds, as pointed out in Point 1, is the fact that it functions as a corporation and a separate entity from the state as shown by the following facts:

(1) The state highway engineer may be appointed by the Authority to serve as *its* engineer in addition to his regular duties as state engineer; in other words, his duty as the engineer of the Authority is separate and distinct from his duty as engineer for the state.

(2) When acting as engineer for the Authority he is to receive additional salary, which is to be fixed by the Authority.

(3) The Authority may employ legal counsel,

(4) It may maintain an office,

(5) It may employ a secretary and such other persons as may be necessary, and finally,

(6) It may sue and be sued in its own name. All of these provisions are found in Section 3 of the Act.

The following section of the Act also indicates that the Authority is a separate entity from the state.

Section 4 provides that the Authority shall *authorize and direct* the Department of Public Works of the State to build toll bridges. Section 4½ provides that it shall *direct* the Department of Public Works to build transportation facilities on any bridge. Section 5 provides that when the Department of Public Works determines that it is for the best interests of the public highways in the state that a new toll bridge

be constructed, the director of said department shall submit its *recommendation* to that effect to the Authority. Said section further provides that if a majority of the members of the California Toll Bridge Authority concur in the recommendation of the Director of Public Works, the Authority shall adopt a resolution declaring that public interest will necessarily require the construction of such a toll bridge, and authorizing the issuance of revenue bonds for the purpose of obtaining funds in an amount not in excess of that estimated to be required for such construction.

Section 51½ also provides that the Department of Public Works shall make its *recommendation* to the Authority in regard to providing transportation facilities for bridges. Section 5¾ is to the same effect in regard to additional facilities. Section 7 provides that the Authority is empowered to fix the rate of toll of bridges.

As authority for the proposition that the California Toll Bridge Authority is a separate entity from the State, we cite *Louisiana Highway Commission v. Farnsworth*, 74 Fed. (2d) 910, 912 and 913, certiorari denied 294 U. S. 729, 79 Law. Ed. 1259. In discussing said case, the Court in *State Highway Commission v. Kansas City Bridge Co.* (supra), said at page 691:

“We think that the true distinction between the case of *Louisiana Highway Commission v. Farnsworth* (supra) and *State Highway Commission of Wyoming v. Utah Construction Co.*, 278 U. S. 194, 73 Law. Ed. 262, is that in the former case the Federal Court had jurisdiction, not because the State Supreme Court had held that

the commission was a legal entity distinct from the state and subject to suit, but because, under the constitution and laws of Louisiana, it was such a legal entity and a citizen of Louisiana—while in the latter case the Highway Commission of Wyoming was a mere representative of the state. No such distinction can properly be made here.”

We also quote from the *Farnsworth* case, cited above:

“The act granting the commission, made it a body corporate which could sue and be sued, and the Supreme Court of Louisiana has held that the commission was a legal entity from the state, not unlike a levee district, on the part of the commissioners of the State of New Orleans.”

See also:

Annotation 306 U. S. 398, 83 Law. Ed. 794.

We quote from page 799 of 83 Law. Ed.:

“* * * And in *Tompkins v. Kanawaha Bd.*, 19 W. Va. 257, a case involving a corporate instrumentality of a state, it was said: ‘The State as such, does not enter into business of any such character. Her business is political and when she wants improvements carried on, she creates corporations with the ordinary incidents thereto, to do that business. It would be against all our ideas of state government if a corporation created for the state to carry on a work of improvement, should not be liable like any other corporation, for the damage it inflicted, notwithstanding the state might own the property of the corporation.’”

We quote from page 810 of 83 Law. Ed.:

“* * * it was held in *Biedermann v. Home Owners' Loan Corp.*, 20 Fed. Sup. 23, that the corporation was liable in an action for money damages for failure to deliver such bonds as agreed, inasmuch as the statute creating the corporation provided broadly that it might sue and be sued, and contained no limitation that for a breach of its agreement to deliver bonds it could be sued, only for specific performance.”

On pages 814 and 815 of 83 Law. Ed., cases are cited which hold that where a state or the U. S. confers upon a governmental corporation, either expressly or by implication, the conventional power “to sue and be sued”, it thereby subjects it to liability in tort.

In discussing the case of *Keifer v. Reconstruction Finance Corporation*, 306 U. S. 387, 83 Law. Ed. 784 (cited in our opening brief), the annotation at page 816 of 83 Law. Ed. states:

“However, in this connection, attention is again called to the observation made in the *Keifer* case that Congress has exhibited a settled policy against immunity of Federal corporations from suit, and that where the power to sue and be sued is given, this ordinarily should include liability to suit in tort as well as in contract.”

Appellee concedes this on page 23 of his brief when he states that the California Supreme Court is not as liberal as the Federal Courts in allowing suits against governmental corporations. In this connection it should be noted that the Federal Court will rely on Federal decisions in deciding whether or not

it has jurisdiction in a certain case based on grounds of diversity of citizenship.

See also:

Federal Housing Administration v. Burr, 309 U. S. 242, 84 Law. Ed. 724.

The case of *Pacific Fruit Co. v. Oregon Liquor Commission*, 41 Fed. Sup. 175, cited on page 23 of appellee's brief, is not authority for the proposition that the appellee in this action is in reality the State of California. That case involved a suit to recover amounts paid by plaintiff for the privilege of doing business in malt syrup in the State of Oregon. The Court stated on page 179 thereof:

"The Oregon Liquor Control Commission is not a corporation. It is a governmental or administrative body and as such, constitutes an arm or alter ego of the state itself."

An analysis of all the cases on this subject leads to the conclusion that the only authority on all fours, so to speak, with our case, is the case cited in our opening brief, to-wit:

Hunkin-Conkey Construction Company v. Pennsylvania Turnpike Commission, cited above. The act creating the Pennsylvania Turnpike Commission is almost exactly the same as the act creating the California Toll Bridge Authority. In both acts it was provided that the costs of the bridge or turnpike should be paid from revenue bonds which were not to be deemed a debt of the State of California or of the commonwealth of Pennsylvania. In both acts it was provided that the authority or commission should

have power to enter into contracts, employ engineers, architects, inspectors and attorneys and such other employees as may be necessary in their judgment, and with the authority to fix their compensations. In both acts it was provided that the actual construction of the structures should be under the supervision of the Department of Highways of the State of California and the State of Pennsylvania respectively, subject to the proviso that all contracts and agreements should be subject to the approval of the Toll Bridge Authority and Turnpike Commission respectively. Both acts provided that upon the completion of the improvement, the Authority or the Commission should fix the amount of tolls and employ men to collect them. The language used by the District Court of Pennsylvania, after quoting the provisions of the Pennsylvania act, can with equal force be applied to our case (p. 28) :

“From the provisions of the act, as above outlined, it is clear that the commonwealth of Penna. has so divorced the defendant commission from the state, that this action is one involving a legal entity distinct from the state, and the state itself is only indirectly interested in the turnpike.”

III.

THE DEPARTMENT OF PUBLIC WORKS WAS THE AGENT OF THE TOLL BRIDGE AUTHORITY IN THE CONSTRUCTION OF THE BRIDGE.

Appellee makes the bald assertion in his brief (p. 11) that the bridge was not built by the Toll Bridge Authority, but rather by the Department of

Public Works. However, the following sections of the act indicate that the Authority was the principal and the Department of Public Works was the agent in the construction of the bridge.

Section 3 of the statute provides that the Director of the Department of Public Works of the State of California is a member of the Board known as the California Toll Bridge Authority. The act further provided that the State Highway Engineer may be appointed by the California Toll Bridge Authority to serve as *its* Chief Engineer in addition to his regular duties as State Highway Engineer, at an additional salary as may be fixed by the California Toll Bridge Authority.

Section 4 of the act provides:

“The California Toll Bridge Authority shall *authorize* and *direct* the Department of Public Works to build toll bridges.”

Section 4½ provides:

“Whenever in the opinion of the California Toll Bridge Authority and in the opinion of the Department of Public Works it is necessary or desirable so to do, the California Toll Bridge Authority shall *authorize* and *direct* the Department of Public Works to build * * * transportation facilities of any toll bridge * * *.”

Section 5:

“Whenever the Department of Public Works determines that it is for the best interests of the public highways in the state that a new toll bridge * * * be constructed * * * the Director of said department shall submit its *recommendation* to that effect to the California Toll Bridge

Authority * * * If a majority of the members of the California Toll Bridge Authority concur in the recommendation of the Department of Public Works, the Authority shall adopt a resolution declaring that public interest and necessity require the construction of such toll bridge * * * and authorizing the issuance of revenue bonds for the purpose of obtaining funds in an amount not in excess of that estimated to be required for such construction."

Section 5 $\frac{1}{2}$ is to the same effect as Section 5 in regard to acquiring transportation facilities for the bridge.

Section 5 $\frac{3}{4}$ is to the same effect as Section 5 in regard to constructing additional transportation facilities for the bridge.

Section 8:

"The Department of Public Works shall have full charge of the acquisition and construction of all such toll bridges and other toll highway crossings as *may be authorized* by the California Toll Bridge Authority * * *."

From these provisions of the act, it is clearly patent that by the very terms of the statute the Department of Public Works was the agent of the California Toll Bridge Authority in the construction of the bridge. The rule of law is so fundamental that a principal is responsible and liable for the acts of its agent, that it needs no citation of authority herein.

The act clearly shows the intent of the legislature that the Department of Public Works should become an instrumentality, or agent, of the Authority in the construction of the bridge. Appellee glosses over this

point and fails to truly evaluate the significance of the fact that at all times the Board of Public Works is the agent of the Authority.

Therefore, on the authority of the *Pennsylvania Turnpike* case, plus the *State of Missouri v. Homestead Life Association*, 90 Fed. (2d) 543, cited in our opening brief (p. 8), appellee has failed to answer or distinguish, and the U. S. Supreme Court cases cited in our opening brief, enunciating the principle that governmental corporations are liable to suit, we respectfully maintain that the California Toll Bridge Authority is a legal entity separate and apart from the State of California. We also believe that when the legislature of the State of California stated in the act creating the Authority, that it was liable to suit, it meant exactly that. There are no words of limitation on the extent of the Authority's liability to suit. Therefore, the appellant in this action had a right to sue said Authority for the claim herein maintained. The California Toll Bridge Authority, being a corporation, is a citizen of California (*Barrow Steamship Co. v. Kane*, 170 U. S. 100, 18 S. Ct. 526, 42 L. Ed. 964, cited in our opening brief, p. 11) and, therefore, there was a diversity of citizenship between the parties hereto and the District Court did have jurisdiction to try this case.

Dated, San Francisco,

March 6, 1942.

Respectfully submitted,

DANIEL V. RYAN,

THOMAS C. RYAN,

Attorneys for Appellant.

In the United States
Circuit Court of Appeals
For the Ninth Circuit

THE BANK OF CALIFORNIA, NATIONAL
ASSOCIATION,

Appellant,

vs.

GEORGE M. McBRIDE, Trustee of Western
Bond & Mortgage Company, a corporation,
Bankrupt,

Appellee.

BRIEF OF APPELLEE

Upon Appeal from the District Court of the
United States for the District of Oregon.

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Circuit Court of Appeals
For the Ninth Circuit

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TABLE OF CONTENTS

	Page
History of the Proceedings.....	1
Summary Proceedings before Referee Cannon	1
Referee Cannon's Findings and Order.....	1
Review of Referee Cannon's Findings.....	2
Judge Fee's Order of May 1, 1939.....	2
Proceeding on Reference to Referee Snedecor	3
Referee Snedecor's Findings.....	3
Hearings before Judge Fee on Referee Snedecor's Findings and on Motion for Rehearing	4
Judge Fee's Order Approving Referee Snedecor's Findings, Denying Motion for Rehearing and Refusing to Set Aside Order of May 1, 1939.....	4
The Bank's Appeal.....	4
Issues for Decision on This Appeal.....	5
Statement of the Facts.....	5
A Diagrammatic Statement of the Facts.....	10
Misstatement of Case in Appellant's Brief.....	15
(1) Misstatement of Fact.....	15
(2) Half Facts	18
(3) Alleged Facts Based on Rejected Evidence	21
Synopsis of Discussion.....	24
I. Preliminary Legal Discussion.....	27
1. Findings of Fact made by a Referee, affirmed on review by the District Judge, must be treated as unassailable upon appeal, if there be any testimony consistent with the finding...	27
2. The denial by the trial judge of a motion for a new trial based on newly discovered evidence will not be re-examined by the Appellate Court.....	30
II. Questions of Jurisdiction.....	32
1. The Bankruptcy Court had summary jurisdiction to determine whether,	

TABLE OF CONTENTS

(Continued)

Page

after the filing of the petition in bankruptcy, the Bank had acquired property possessed by the Bankrupt at such time, and, if so determined, to require that such property be surrendered to the Trustee.....	32
2. The Bankrupt at the time of the filing of the petition possessed the property in the Ranch, since the Keystone was not a claimant holding the Ranch adversely to the Bankrupt.....	32
(a) It was the agent of the Bankrupt	32
(b) It was the alter ego of the Bankrupt (piercing the veil of corporate entity)	37
3. Keystone was not the holder of an adverse interest or of any interest in the mortgage	44
4. Ownership of mortgage indebtedness is constructive possession of property, and if ownership in Bankrupt existed at bankruptcy, summary jurisdiction lies	45
5. Possession of the mortgage (document) by Bankrupt was not essential when ownership of mortgage was actually in Bankrupt and stood in its name of record, with no assignment of ownership of record or otherwise to another	50
6. Though the Bank may claim to be a bona fide purchaser for value of the Ranch, such claim, assuming possession was in the Bankrupt at the time bankruptcy, could not defeat the Court's jurisdiction summarily to determine such claim	53
7. Statements of the Bank that mortgage debt in favor of the Western had been	

TABLE OF CONTENTS

(Continued)

Page

paid or had no value, or had been discharged by exchange of consideration, are not based on evidence before the Court. However, such questions are ones of fact, certainly not of jurisdiction, and since there was evidence to the contrary, this Court will not review the findings..... 60

8. Drainage District Bonds transferred to Bank in same situation as transfer of Ranch 63

III. Questions Concerning Improvements, Expenditures and Receipts..... 63

1. The Bank was not a bona fide purchaser for value..... 63

2. Moneys paid after bankruptcy to another in order to obtain property of the Bankrupt cannot be recovered from the Bankrupt's estate..... 72

3. The Bank, being in unlawful possession of the Ranch, will not be allowed credit for alleged permanent improvements, since it was not a purchaser in good faith, without notice and for value 74

4. The order concerning rental value of the Ranch merely fixed the value of the use of the Ranch, against which value allowed credits for advances may be offset; and although the determination be res adjudicata between the parties, it is not a judgment enforceable as such without further court action 76

5. Money paid to the Bank for a portion of land sold out of land unlawfully acquired stands in lieu of the land itself, and the turnover order is proper where money is still held..... 77

- Conclusion 79

TABLE OF AUTHORITIES CITED

Page

Acme Harvester Co. v. Beekman Lumber Co., 222 U.S. 300, 22 Sup. Ct. 96, 99; 56 L. Ed. 208....	47
Alexander v. Theleman (C.C.A. 10th), 69 F. (2d) 610, 611	30
Bastanchury Corp'n., In re, 62 F. (2d) 537, 542..	52
Beneke v. Moss (C.C.A. 4th), 46 F. (2d) 948, 949	30
Bennett v. Semmes (D.C.E.D., Ark.), 287 F. 745.	59
Borok, In re (C.C.A. 2nd), 50 F. (2d) 75, 79....	48
Brannow v. Robbins (C.C.A.D.C.), 50 F. (2d) 499, 500	29
Buss v. Long Island Storage Whse. Co., 64 F. (2d) 338	43
Chicago, M. & St. P. Ry. Co. v. Minneapolis Civic & Commerce Assn., 247 U.S. 490, 38 Sup. Ct. 553, 556-557; 62 L. Ed. 1229.....	38
City of Long Beach v. Metcalf (C.C.A. 9th), 103 F. (2d) 483, 486.....	34
Clements v. Coppin (C.C.A. 9th), 72 F. (2d) 796, 798	29
Clendening v. Red River Valley Nat. Bank, 11 A. B.R. 245, 12 N.D. 94.....	77
Clere Clothing Co. v. Union T. & S. B. Co. (C.C.A. 9th), 224 F. 363, 364.....	39
Club New Yorker, In re, 14 F. Supp. 694.....	43
Davis v. Schwartz, 155 U.S. 631, 637; 39 L. Ed. 289, 293	27
Del. & H. R. Corp'n. v. Cottrell (C.C.A. 3rd), 69 F. (2d) 195, 198	31
Duffy Players, In re (C.C.A. 9th), 50 F. (2d) 737, 738	28-29
Eilers Music House, In re (C.C.A. 9th), 270 F. 915 (Certiorari denied 42 Sup. Ct. 55).....	39
Erie R. Co. v. Irons (C.C.A. 3rd), 48 F. (2d) 60, 63	31
Gray v. Breslof, 273 F. 526.....	59
Harrison v. Chamberlain, 271 U.S. 191, 46 Sup. Ct. 467, 70 L. Ed. 897.....	43
Henry v. Postal Tel. Co., 100 Ore. 179, 187; 197 P. 258	31
Hill v. Douglass (C.C.A. 9th), 78 F. (2d) 851, 853	29

TABLE OF AUTHORITIES CITED

(Continued)

Page

Houston Oil Co. v. Wilhelm (C.C.A. 5th), 182 F. 474	71
Hunter v. MacFarland, 45 F. (2d) 994.....	28
LeBlanc v. Fidelity Tr. Co. (C.C.A. 1st), 65 F. (2d) 442, 443.....	29
Lincoln v. Peoples Nat. Bank (D.C. Mich.), 260 F. 422	77
Marcel v. Engebretson (C.C.A. 8th), 74 F. (2d) 93'	43
May v. Henderson, 268 U.S. 111, 45 Sup. Ct. 456, 69 L. Ed. 870.....	46
McCulloch v. Davenport Sav. Bank (D.C. Iowa), 226 F. 309	77
Metz. v. Knobel (C.C.A. 2nd), 21 F. 317, 318....	17
Morrison v. Parkway Nat. Bank (C.C.A. 2nd), 60 F. (2d) 41	54-56
Mueller v. Nugent, 184 U.S. 1; 22 Sup. Ct. 269, 46 L. Ed. 405.....	43
Mullen, In re (D.C. Mass.), 101 F. 413.....	57-58
Myers v. Hazzard (C.C. Neb.), 50 F. 155.....	56
Neece v. Durst (C.C.A. 9th), 61 F. (2d) 591, 593.	29
N. Y. Life Ins. Co. v. Seifris (C.C.A. 3rd), 46 F. (2d) 391, 393	31
O'Brien v. Gen. Acc. Fire & Life Assurance Corp'n. (C.C.A. 8th), 42 F. (2d) 48, 49.....	31
O'Dell v. Boyden (C.C.A. 6th), 150 F. 731, 736..	49
Oriel, In re (C.C.A. 2nd), 23 F. (2d) 409, 410...	29
Orinoco Iron Co. v. Metzel (C.C.A. 6th), 230 F. 40, 44-45	47
Paddock v. Fish (D.C.S.D.N.Y.) 10 F. 125.....	59
Peninsular Bank v. Wolcott (C.C.A. 4th), 232 F. 68	59
Plack v. Banner (C.C.A. 3rd), 121 F. (2d) 676, 678	30
Pittsburgh, Cinn.-St. L. R. R. Co. v. Heck, 12 Otto 120, 102 U.S. 120, 26 L. Ed. 58, 59.....	30-31
Ramish, Inc. v. Langhorn (C.C.A. 9th), 86 Fed. (2d) 886-888	41
Ransford, In re (C.C.A. 6th), 194 F. 658, 663..	47, 48
Robbins v. Winters Creek Canal Co. (C.C.A. 8th), 109 F. (2d) 849, 851.....	30

TABLE OF AUTHORITIES CITED

(Continued)

Page

Seattle Curb Exchange v. Knight (C.C.A. 9th), 46 Fed. (2d) 34, 35.....	48
Shannon v. Shaffer Oil & Refining Co. (C.C.A. 10th), 51 F. (2d) 878, 881.....	31
Shea v. Lewis (C.C.A. 8th), 206 F. 877.....	43
Springmann v. Gary State Bank (C.C.A. 7th), 124 F. (2d) 678, 680.....	30
Stone v. Eacho (C.C.A. 4th), 127 F. (2d) 284, 288 (Advance Sheets Vol. 2).....	40
Stonebraker-Zea Cattle Co. v. U. S. (C.C.A. 8th), 220 F. 99, 101	71
Street v. Pacific Indemnity (C.C.A. 9th), 61 F. (2d) 106, 107-109.....	49
Swift v. Higgins (C.C.A. 9th), 72 F. (2d) 791, 793	29
Walker v. Lightfoot (C.C.A. 9th), 124 F. (2d) 3, 6	29
Western Bond & Mortgage Co., In re (D.C. Ore.), 44 Fed. Sup. (Adv. Sheets No. 1) 89, 94....	75, 79
Wetzel v. Schaefer (C.C.A. 5th), 124 F. (2d) 308, 310	30
Willoughby, In re (C.C.A. 6th), 95 F. (2d) 932, 933	30
Wood v. Naimy (C.C.A. 9th), 69 F. (2d) 892, 895	29
Worrall, In re (C.C.A. 2nd), 79 F. (2d) 88, 89..	48

CODES, STATUTES AND RULES

O.C.L.A., Sec. 8-206.....	76
O.C.L.A., Sec. 70-127.....	51
O.C.L.A., Sec. 70-130.....	51
General Order in Bankruptcy No. 37.....	27, 28, 29
Rules of Civil Procedure for Dist. Cts. of U. S. No. 52(a)	27, 28, 29

TEXTBOOK

Pomeroy on Equity Jurisprudence, Vol. II, Sec. 74, p. 205	71
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HISTORY OF THE PROCEEDINGS

SUMMARY PROCEEDINGS BEFORE REFEREE CANNON

The Trustee in Bankruptcy herein on July 16, 1936, filed a petition for an order against the Bank of California requiring it to turn over to the Trustee property of the Bankrupt which it had acquired after the filing of the petition in bankruptcy, namely: certain real property known as the Russell Ranch in Oregon, and certain Bonds, which petition was thereafter amended (Tr. 18-30). The order to show cause was issued and the Bank of California challenged the jurisdiction of the Court to hear such matter summarily (Tr. 35-38). The Referee, upon said challenge, determined that the Court had summary jurisdiction (Tr. 38-45). Thereupon, the Bank filed its answer to the petition and to the order to show cause, wherein it renewed its challenge to the jurisdiction and maintained its right to hold the property it had acquired (Tr. 45-58).

REFEREE CANNON'S FINDINGS AND ORDER

After hearing, the Referee filed his opinion, wherein he concluded "that the Bank must by order be required in some manner to restore the assets attempted to be destroyed by the instruments filed . . . on March 2, 1932, . . . and an order to this effect may be settled on service and notice" (Tr. 58-69). Thereupon, detailed findings and conclusions were filed (Tr. 69-83) and an order made (Tr. 83-89). The order directed the Bank to deed to the Trustee the Russell Ranch and to turn over the bonds. It further gave the Bank the option, within

ten days from the date of the order, in lieu of turning over the Ranch, to pay to the Trustee \$65,000.00, the determined value of the Ranch, and \$1,000.00, the determined value of the bonds, with interest from the date of acquisition by the Bank.

REVIEW OF REFEREE CANNON'S FINDINGS

Petition for review of this order was filed by the Bank (Tr. 90-95). Judge Fee, in an opinion filed February 27, 1939 (Tr. 106-110), determined that the Referee's findings were correct and should be affirmed, and likewise that the Referee's order should be approved with the exception of the optional right given to the Bank to pay money in lieu of property.

JUDGE FEE'S ORDER OF MAY 1, 1939

Judge Fee in an order made May 1, 1939, affirmed all of the Referee's findings (Tr. 111-112) and re-referred the matter to the Referee for the purpose of determining what, if any, allowance should be made for expenditures by the Bank upon the property, since the Bank in Paragraph XIII of its answer claimed to have expended certain moneys for improving the ranch property (Tr. 55-56). In view of the fact that Referee Cannon's term had expired, the matter was referred for such purpose to Referee Estes Snedecor, his successor. (Tr. 104-106).

PROCEEDINGS ON REFERENCE TO REFEREE SNEDECOR

Before Referee Snedecor the Bank attempted to introduce evidence "tending to show that the bankrupt received, directly or indirectly, a part of the consideration paid by the Bank to the Massachusetts Mortgage Co. for the assignment of the mort-

gages on the Russell Ranch." The Referee excluded this evidence, since he construed the order as confining "the limits of the present inquiry to such facts not found by the former findings" (Tr. 116-117). The former Referee had found that the Western had received nothing.

REFEREE SNEDECOR'S FINDINGS

After hearing the evidence introduced, Referee Snedecor found (Tr. 112-145) that the Bank was not entitled to any allowance for so-called improvements made by it upon the property, since it was not a bona fide purchaser for value of the property, but that it was entitled to a credit, against the reasonable rental value of the Ranch, for taxes paid by the Bank which the Trustee would have been obligated to pay in any event, and also for certain rentals paid by the Bank on outside lands for grazing purposes. These taxes and rentals aggregated \$9,546.38. Referee Snedecor found the reasonable rental value of the Russell Ranch during its occupancy by the Bank, exclusive of the use of the permanent improvements made by it, to be \$3000.00 per year, against which the \$9,546.38 was to be credited. He also found that the Trustee was entitled to the sum of \$10,000.00 which the Bank had received from the State Highway Commission for a right-of-way for highway purposes over said Ranch (Tr. 144).

HEARINGS BEFORE JUDGE FEE ON REFEREE SNEDECOR'S FINDINGS AND ON MOTION FOR REHEARING

Whereupon, the Trustee moved to confirm the findings of Referee Snedecor (Tr. 145-152) and the

Bank filed objections to said findings (Tr. 152-163). The Bank also filed at the same time a motion for rehearing of the findings made by Referee Cannon, approved on review by the Court in its order of May 1, 1939 (Tr. 164) based on newly discovered evidence (Tr. 164-172). Attached to said motion were affidavits referring to said so-called newly discovered evidence (Tr. 172-188). The motions and objections were heard by Judge Fee and on November 17, 1941, Judge Fee filed his opinion (Tr. 188-213), affirmed Referee Snedecor's findings, and refused to set aside his previous order affirming Referee Cannon's findings.

**JUDGE FEE'S ORDER APPROVING REFEREE SNEDECOR'S
FINDINGS, DENYING MOTION FOR REHEARING AND
REFUSING TO SET ASIDE ORDER OF MAY 1, 1939.**

Whereupon an order was entered overruling objections to the Referee's report and affirming and carrying into effect his recommendations (Tr. 222-227), and an order was likewise made upon the motion to rehear, refusing to set aside his order of May 1, 1939, which had affirmed the findings of Referee Cannon.

THE BANK'S APPEAL

The Bank of California thereupon appealed.

ISSUES FOR DECISION ON THIS APPEAL

Since the facts in this case have been passed upon by two Referees and approved and affirmed on review in each instance by District Judge Fee, and again reviewed by Judge Fee upon motion for re-

hearing, which motion he denied, it is confidently asserted that the facts in this six year long litigation will not be re-examined except to discover if there were any evidence on which the findings were based (see Discussion pp. 27 to 30 this Brief and Appendix hereto). In view of the fact that the barest perusal of the evidence will speedily disclose that there was a plethora of testimony on which to base the findings, the only issues, therefore, for decision by this Court are those of law. They are:

(1) Did the Bankruptcy Court have summary jurisdiction to determine the controversy under the facts adduced?

(2) Having determined that the Bank of California had acquired the Bankrupt's property neither in good faith nor without notice, nor for a present consideration, did the Court properly disallow reimbursements to the Bank for asserted improvements?

However, we must perforce set forth the facts in this Brief since they have been inaccurately and misleadingly set forth under the heading "Statement of the Case" in Appellant's Brief (pp. 3-13). We shall call specific attention to particular misleading statements following our Statement of Facts.

STATEMENT OF THE FACTS

The Western Bond and Mortgage Company (1) was indebted to the Bank of California, N.A., in the

(1) For Brevity, the Western Bond and Mortgage Company will hereafter be demnoinated Western, and after the first mention hereafter of their respective names, the following companies will be referred to as follows: The Bank of California, N. A. as "Bank", Massachusetts Mortgage Co. as "Massachusetts", Keystone Finance Co. as "Keystone" and Ochoco Farms Corporation as "Ochoco".

amount of approximately \$103,000.00.⁽¹⁾ During the year 1931 and prior to bankruptcy, the Bank procured collateral from the Western in the endeavor to protect in part this indebtedness (Tr. 362). Since such collateral was deemed insufficient to protect the Bank fully, it began to press the officers of the Western to obtain as far as possible a liquidation in full of the indebtedness (Tr. 361-2, 363). While this pressing process was in progress, there was filed on November 25, 1931, a petition in bankruptcy against the Western (Tr. 3-5). The Bank had knowledge of the filing of this petition (Tr. 252, 369, 370, and Trustee's Ex. 31).⁽²⁾ After the filing of the petition, the Bank entered into negotiations (Tr. 262-263, 344, 362-363) with the Western through its new management (Tr. 262) under E. F. O'Flynn, then its Secretary-Treasurer (Tr. 300-1), and afterwards its President (Tr. 300), who was also head of the Massachusetts Mortgage Co. (Tr. 262, 369, also Ex. 30). This latter company owned all of the capital stock of the Western (Tr. 349, 369) and of the Ochoco Farms Corporation (Ex. 10, Tr. 255). The negotiations resulted in the Bank first crediting the Western's obligation with an amount equal to the value of the Western's collateral held (Tr. 336), and then by the Bank taking an assignment of a note for \$55,960.00 (Tr. 337) secured by a first mortgage on the Russell Ranch (Tr. 338; Ex. 20,

(1) See admissions of Bank in Paragraph VII of its Answer to the Trustee's Petition for Order to Show Cause (Tr. 49).

(2) Exhibit 31 is the Credit file of the Bank on the Western. In it is a memo under date of Nov. 28, 1931, as follows: "11-28-31. Daily Journal of Commerce Western Bond and Mortgage Co.—Involuntary Petition in Pankruptcy B.D." Also, a communication or report from Bradstreet Company to the Bank of California dated Nov. 28, 1931, informing the Bank of the filing of the petition against the Western on Nov. 25, 1931.

Tr. 307), which the Bank caused to be appraised and found to be of a value of \$65,000.00 (Tr. 386 and Ex. 30). Thereupon, the Bank gave to the Western a full release of indebtedness (Ex. 22, Tr. 309; Tr. 346, 396, 397). The amount owing the Bank plus certain advances made to the Massachusetts, less the value of the securities held which the Western assigned unconditionally to the Bank, was \$55,960.00 (Tr. 337)—the exact amount of the assigned secured note.

The taking of the note for \$55,960.00 and its obtaining of the mortgage securing the same, arose through the following circuitous method:

At the time of the bankruptcy, the Western was the owner of all the capital stock of the Keystone Finance Co. (Ex. 7, Tr. 277-8, 296-7). The officers and directors of the Keystone were women office employees and stenographers of the Western (Tr. 282-4, 292-295, 294, 298-303, 300). They admittedly did the bidding of the President of the Western, using no independent judgment (Tr. 283-4). They received no salary or other compensation from the Keystone (Tr. 302) and their entire compensation came from the Western (Tr. 302). They held only qualifying shares in the Keystone and owned no interest in such shares (Tr. 299). The Keystone's office, if it had one, was the office of the Western (Tr. 302), and it did not participate in paying for the same (Tr. 302).

Title to the Russell Ranch at the time of Bankruptcy was in the Keystone,⁽¹⁾ but the Western held

(1) See Paragraph II of Trustee's Petition for Order to Show Cause (Tr. 19-20) and Paragraph II of Answer of Bank to said Petition (Tr. 48).

two mortgages against it securing notes of the Keystone for \$150,000.00⁽²⁾—an amount far in excess of its value (Tr. 386).

After the filing of the petition in bankruptcy against the Western, there was caused (Tr. 289) to be filed Articles of Incorporation of the Ochoco Farms Corporation. The Ochoco's officers and directors were the same stenographers and clerks of the Western who were officers of the Keystone, excepting that a Miss Thibodeaux, also a stenographer of the Western (Tr. 294), was substituted for Miss Smith. No incorporators', no stockholders', and no directors' meetings of the Ochoco were held (Tr. 287-8 and Ex. 12). No subscription to the stock was made (Tr. 286 and Ex. 12); no oath of Directors was taken (Tr. 288 and Ex. 12). The Ochoco had no bank account (Tr. 295); no business was ever transacted by it (Tr. 291). It paid no license fee to the State of Oregon, excepting that paid upon organization, and it was dissolved by action of the State for failing to pay such license fees (Tr. 292-3, Exs. 12A and 12B). The Keystone was then caused to give to Ochoco a deed to the Ranch. (Ex. 18, Tr. 305-6.)

The simulated character of the transactions is demonstrated by the fact that *five days prior to the incorporation of the Ochoco* (Ex. 9, Tr. 284), the Ochoco accepted the transfer of the Ranch property from the Keystone (Ex. 19, Tr. 306-7). No consideration was received for this transfer (Tr. 306, 341).

(2) See admissions in Paragraph III of Answer of Bank to Trustee's Petition for Order to Show Cause (Tr. 48).

The officers signing the deed were E. E. Gallagher, President, and Miss B. O'Reilly, Assistant-Secretary (Tr. 305-6). Simultaneously and without consideration (Tr. 332-3; and see also Trustee's Exhibit 18-C under the Snedecor Hearing), the Western satisfied the first mortgages which it held upon the Ranch (Ex. 7, Tr. 305).

The next step taken was immediately to cause the Ochoco to execute and deliver to the Massachusetts a note of \$55,960.00, secured by a mortgage on the Russell Ranch (Ex. 20, Tr. 307). The mortgage from Ochoco to Massachusetts was signed in the name of the Ochoco by E. E. Gallagher, President, and B. O'Reilly, Secretary, the same individuals who signed the deed from Keystone to Ochoco.

Then the Massachusetts, owning all the stock in the Western (Tr. 269), assigned to the Bank the note and mortgage given to it by the Ochoco.

The Bank had full knowledge of these circuitous transfers and transactions (see Ex. 30, Tr. 413), for its attorney held all the deeds, mortgages, satisfactions of mortgage, notes and assignments in escrow (Tr. 262-3, Ex. 22), and, upon the Bank satisfying itself that the property was worth \$65,000.00, recorded all of them simultaneously (Tr. 260, 411). All of these instruments, including the deed of the Ranch to Ochoco were returned to the Bank's attorney (Tr. 411).

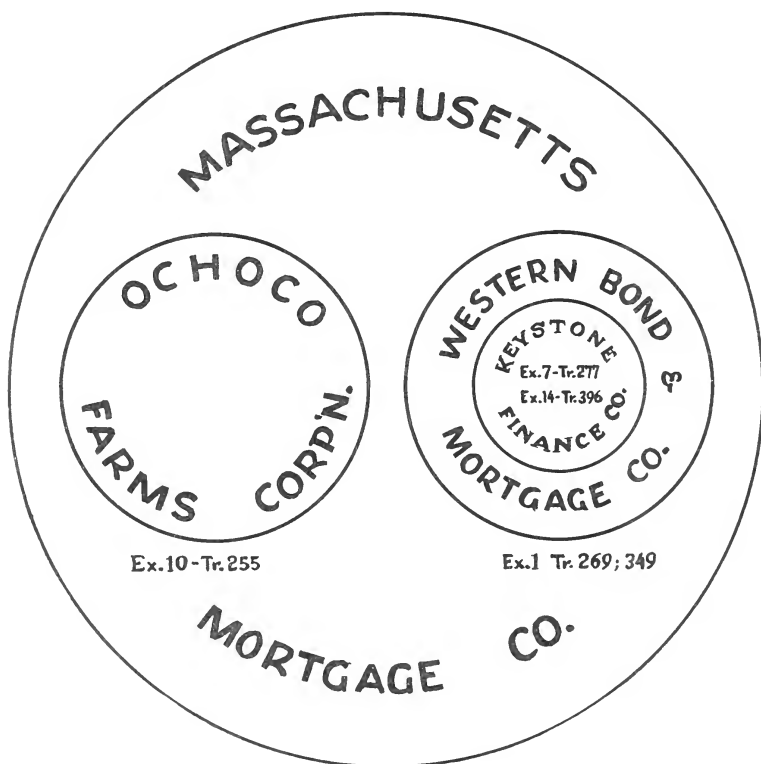
It is believed that the facts in this case can be grasped more readily and with less turning of pages if they are re-stated in succinct diagrammatic form. Accordingly, we present:

A DIAGRAMMATIC STATEMENT OF THE FACTS

DIAGRAM SHOWING

INTERLOCKING STOCK-OWNERSHIP IN VARIOUS CORPORATIONS INVOLVED,

WITH OVERALL COMPLETE OWNERSHIP IN MASSACHUSETTS.



INTERLOCKING OFFICES AND DIRECTOR-
SHIPS OF WHAT JUDGE FEE DESIGNATED
THE DRAMATIS PERSONAE OF THE VARIOUS
CORPORATIONS (Tr. 190)

	Massachusetts Mortgage Co.	Western Bond & Mtg. Co.	Keystone Finance Co.	Ochoco Farms Corpn.
<u>MR. E. F. O'FLYNN</u> Directing Force	President (Tr. 369) Director (Tr. 369)	Secty-Treas. (Tr. 281) President (Tr. 301) Director (Tr. 278)		
<u>MISS E. E. GALLAGHER</u> Stenographer of Western, owning no stock in any of the corporations, and holding merely qual- ifying share (Tr. 282-4, 294) and doing biddings of Western's President (Tr. 282-4, 292-5,300).	Director (Tr. 283)	Asst.-Treas. (Tr. 281) Director (Tr. 271, 281)	President (Tr. 298) Director (Tr. 298)	President (Tr. 293) Director (Tr. 293)
<u>MISS LOUISE N. THIBE- DEAUX</u> Stenographer of West- ern, owning no stock in any of the corpora- tions, holding merely qualifying share (Tr. 282-4) and doing busi- ness of Western's Pres. (Tr. 282-4, 292-5,300).	Director (Tr. 283)	Asst-Secty (Tr.281) Director (Tr. 281)	Secretary (Tr. 306)	Vice-Pres. (Tr. 294) Director (Tr. 293)
<u>MISS B. O'REILLY</u> Ditto			Vice-Pres. (Tr. 298) Director (Tr. 298)	Secty-Treas. (Tr. 294) Director (Tr. 293)

DIAGRAM SHOWING CIRCUITOUS
TRANSFERS FROM WESTERN
TO BANK

(ALL TRANSFERS OUT OF WESTERN WERE MADE AFTER BANKRUPTCY AND RECORDED
SIMULTANEOUSLY BY BANK'S ATTORNEY - TR. 415)

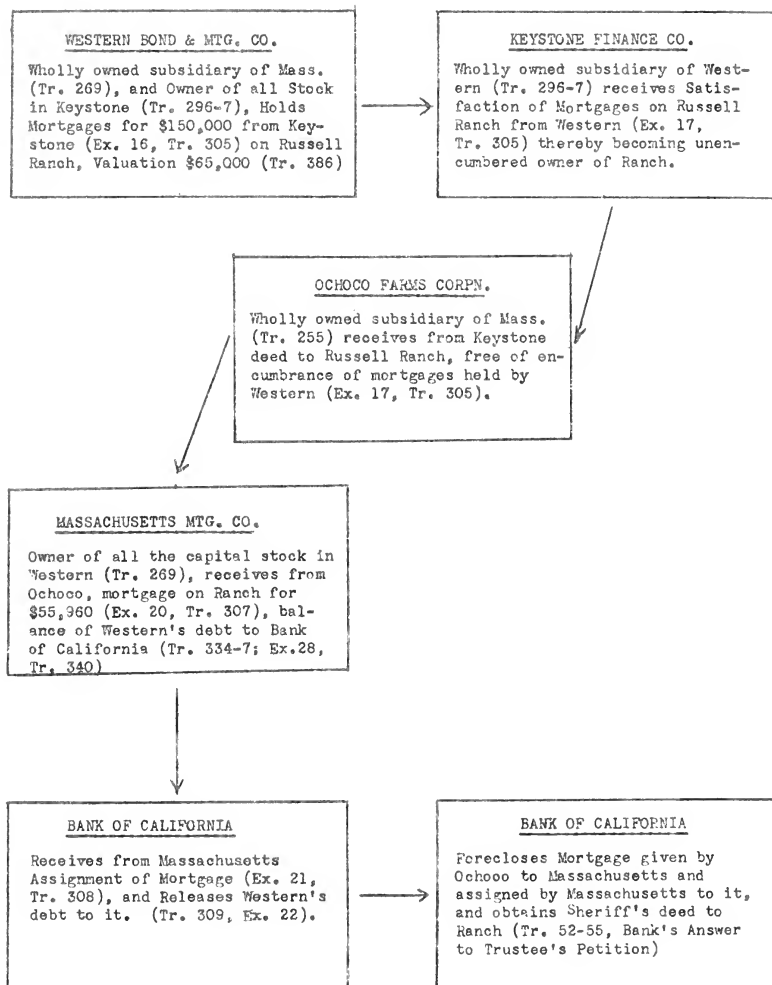


DIAGRAM OF SIMULATED CONSIDERATIONS FOR SATISFACTIONS, DEEDS, MORTGAGES AND ASSIGNMENTS OF MORTGAGES

WESTERN TO KEYSTONE

Satisfaction of Mortgages

Testimony shows that no consideration was received by the Western (Tr. 331-333)



KEYSTONE TO OCHOOCO

Deed

Keystone purported to have received 650 shares of the preferred stock of Western from Keystone (Tr. 306).

But, testimony shown owned no such shares (Tr. 340-1). And deed from Keystone (Ex. 18, Tr. 305-6) shows property conveyed to Ochoco five days before Ochoco was organized. (Tr. Ex. 9, Tr. 284, 289.)



OCHOOCO TO MASSACHUSETTS

Mortgage \$55, 960

Purported Consideration: Need by Ochoco to Borrow Money (Ex. 12--Minute Book of Ochoco. Minutes of a purported directors' meeting held half hour before directors elected and signed by officers also half hour before they were elected.)

But, Ochoco never did any business (Tr. 291); never had a bank account (Tr. 295).



MASSACHUSETTS TO BANK

Assignment of Mortgage

Release of Western's debt to Bank.

But, debt released after bankruptcy (Tr. No present consideration.

SITUATION OF PARTIES ON NOVEMBER 25, 1931

(AT DATE OF BANKRUPTCY - Tr. 204)

WESTERN

Owns \$150,000 Mortgage
on Russell Ranch.

(Value of Ranch -
\$65,000)

KEYSTONE

(Western's Wholly
Owned Subsidiary)

Holds Naked Fee
in Russell Ranch
(Value \$65,000)
Subject to Mort-
gage to Western
for \$150,000

BANK

Holds Claim against
Western for \$103,000
--Partially Secured--

Securities later applied
on account Western's
indebtedness, leaving
balance unsecured.

SITUATION OF PARTIES ON MARCH 2, 1932

(AFTER BANKRUPTCY AND AT DATE OF RECORDATION OF

INSTRUMENTS BY BANK - Tr. 415)

WESTERN

Mortgage gone.

Western's securities,
held by Bank, gone.

Debt to Bank dis-
charged.

KEYSTONE

Fee in Ranch
gone.

BANK

Holds Mortgage on Ranch
securing \$55,600. Mort-
gage subsequently fore-
closed and Ranch bought
in, at Sheriff's Sale, by
Bank.

Holds securities absolute-
ly.

Western's debt to Bank
discharged.

MISSTATEMENT OF CASE IN APPELLANT'S BRIEF

As heretofore stated, the Appellant in its Brief presents an entirely erroneous factual picture of the case. Under guise of stating the facts in its "Statement of the Case" (pp. 3-13), it indulges (1) in many direct misstatements of fact, (2) in many statements of half facts, and (3) in many statements of fact based on rejected evidence. To such an extent are these elements injected in Appellant's "Statement of the Case", it is believed that that portion of its Brief will be disregarded by this Court. Some examples of each category, culled from many, are

(1) Misstatements of Fact

(a) "The Bank had no knowledge of the actual facts on which the Bankrupt later claimed its interest." (Appellant's Brief, p. 3)

The testimony showed that the Bank did have such knowledge, including actual knowledge of the filing of the petition in bankruptcy (see Note (2) p. 6 of this Brief). See also testimony of Thos. G. Greene, attorney for the Bank, in regard to his knowledge of the chain of title (Tr. 267). See statement of Thos. G. Greene, Tr. 369-370: "They (the Bank) had all the information I had."

(b) "A new corporation, Ochoco Farms Corporation, was formed, the stock of which was acquired by Massachusetts in exchange for 850 shares of the preferred stock of Western. These preferred shares were transferred by Ochoco to Keystone for title to the Russell Ranch." (Appellant's Brief p. 7)

The testimony showed that there were no such shares owned by the Massachusetts or by the Keystone (Tr. 340-341), so, of course, they could not have been transferred.

(c) "On several other occasions he tried to question O'Flynn about the relations and transactions of the various companies of the Massachusetts Group." (App. Br. p. 8)

Mr. Greene in his testimony (Tr. 266) stated: "In fact I asked very little about it."

(d) "The Bank dealt solely with O'Flynn as principal executive of the Massachusetts." (App. Br. p. 9)

O'Flynn was President of the Western, and there is no evidence in the record to show that the Bank dealt with O'Flynn solely in the one capacity.

(e) "The Bank did not know what corporation owned the Russell Ranch before it was transferred to the Ochoco." (App. Br. p. 9)

The testimony is that Attorney Greene knew and Attorney Greene stated that the Bank actually knew all that he knew (Tr. 370).

(f) "Attorney Greene's knowledge was limited to facts pertaining to the title and corporate resolutions." (App. Br. p. 9)

It is shown by Attorney Greene's testimony that before the subject of the transfer involving an examination of the title arose, Attorney Greene attended various trials brought against the Western in the state court and in the federal court and heard many charges made against the Western (Tr. 252, 256, 400, 406). He attended these trials "because the Bank of California was trying to get some *addi-*

tional security from the Western Bond & Mortgage Company" (Tr. 403). Moreover, prior to the request of the bank to have Mr. Greene examine the title, Mr. Greene had several interviews with Mr. O'Flynn, wherein Mr. O'Flynn made "various proposals to the Bank on behalf of the Massachusetts Mortgage Company as to what he was going to do in order to obtain discharge and release of the Bank of its claim against the Western Bond & Mortgage Company" (Tr. 262). Mr. Greene "suggested to him that pending the conclusion of the negotiations and the acceptance or rejection by the Bank of these various proposals that he had better leave the papers with me in escrow so there would be something besides chin music to rely upon" (Tr. 262). Mr. Greene further stated (Tr. 393): "I had seen the financial statement of the Western Bond & Mortgage Company and the financial statement of the Massachusetts Mortgage Company. . . . I had seen them before this matter was consummated." (Of course, Mr. Greene did not have to see statements of the Massachusetts or of the Western in order to pass on the title to the Russell Ranch.) So, it is obvious that the statement in Appellant's Brief that "Mr. Greene's knowledge was limited to facts pertaining to the title" is not a true statement of the evidence.

(g) "This line of reasoning raised important issues (a) whether the Keystone mortgage had any value and whether the debt it secured had not been paid, and (b) whether it actually was in possession of the bankrupt at the time the bankruptcy petition was filed.

"No evidence had been introduced with regard to either of these issues. There was no al-

legation in the petition with regard thereto, nor had the referee made any finding thereon." (App. Br. 11-12)

The record is replete with evidence as to these issues, and we merely refer to our analysis in the Appendix of this Brief. As to the allegations in the petition, we refer the Court to Paragraphs III and V, Tr. pp. 22 and 23, Paragraphs IX, X and XI, Tr. pp. 24-27, and Paragraph XIII, Tr. p. 28. As to the statement that the Referee made no findings in regard to said issues, we refer the Court to Finding No. 5, Tr. p. 73, and Finding No. 17 and No. 18, Tr. pp. 78-79.

(2) Half Facts

(a) "Keystone owned real property. Such a property was the Russell Ranch." (App. Br. 4)

The only piece of real property which was owned by the Keystone—if it actually owned that—was the Russell Ranch. The implication of the statement is that the Keystone owned other real property. There is no such evidence in the record and it is not a fact.

(b) "Keystone acquired the Russell Ranch on December 20, 1929, from Russell Land & Livestock Co. and mortgaged it to Western, to secure two notes for \$72,500 and \$77,500, respectively." (App. Br. 4)

The implication conveyed by this statement is that the Keystone purchased the Russell Ranch from a detached owner and that subsequently it was mortgaged to the Western. As a matter of fact, the property was transferred to the Keystone by a wholly owned subsidiary of the Western. The Rus-

sell Ranch and Livestock Company was in the same category as the Keystone. All the stock in each was wholly owned by the Western (Ex. 7, Tr. 277-8), and the Western simultaneously caused the Keystone to execute a mortgage thereon for a sum far in excess of its value.

(c) "The Bank executives made a careful check as to the integrity and financial responsibility of Massachusetts and the reports which they received were extremely favorable. They acted on these and upon Mr. Greene's unqualified opinion as to the validity of the mortgage." (App. Br. 9)

As a matter of fact, the Bank made this investigation of the Massachusetts for the purpose of making to the Massachusetts a loan of \$20 000.00 and took collateral from the Massachusetts to secure this loan. So, even had the contemplated deal not gone through, the Bank was well protected (Tr. 348-51). The loan was made before any report on the title was made by Mr. Greene (Tr. 336).

(d) "In December, 1931, O'Flynn asked the Bank whether it would be interested in making a new loan to Massachusetts, releasing Massachusetts and Western from the existing obligation and accepting in lieu thereof a mortgage on the Russell Ranch. Neither of the Bank's executives with whom this proposition was discussed knew anything about the Ranch or who owned it. They were at first 'extremely cool' towards the proposition because it meant making a new loan of additional money to the Massachusetts Group. Nevertheless, the Bank sent an appraiser to examine and report on the value of the property and finally told O'Flynn that it would advance Massachusetts the \$20,000 requested and release the outstanding indebtedness of Massachusetts and Western, provided

that the Bank's attorney, Thomas G. Greene, would approve the title and the validity of the Bank's proposed mortgage as a first lien on the property." (App. Br. 6-7)

There is no testimony in the record concerning the making of a *new loan*. On the contrary, Exhibit 29 (Tr. 379), a letter from the head office of the Bank to its branch, refers to the transaction as "a switch of liability". The testimony concerning knowledge of the Bank as to the ownership of the Ranch was that the Bank knew at the time of the transfer of the mortgage who owned the Ranch immediately prior to that time, or at least that Mr. Greene, its attorney, knew it and Mr. Greene's testimony was that the Bank knew what he knew. The Bank sent its appraiser to the property after it advanced to the Massachusetts at least a portion of the \$20,000.00. Mr. Alward, Manager of the Portland Branch of the Bank, testified, "Yes, some money was advanced before we received our final report" (Tr. 364). All of the money was loaned before Mr. Greene made his report (Tr. 336, Ex. 27-a, b and c). The testimony is also to the effect that the Bank, prior to receiving transfer of the mortgage, loaned the Massachusetts \$20,000.00 on the Massachusetts's own note, secured by ample collateral, after investigating thoroughly its financial standing and after thoroughly investigating the collateral.

(e) "Two years later the District Court rendered an opinion dated February 27, 1939, approving the order in part and disapproving it in part, and at the same time holding that appellant had acted in good faith in trying to collect its indebtedness and had paid valuable consideration for its mortgage." (App. Br. 11)

What the Court did was to sustain the Referee's Findings in full and approve the order made so far as restitution of the property was concerned. It set aside merely that portion which gave the Bank the option to pay the value of the property with interest from date of its acquisition (Tr. 111-2). The matter was re-referred solely for the purpose of determining whether under the allegations of Paragraph XIII of the Bank's Answer (Tr. 55-56) the Bank was entitled to offsets for improvements and advances made after it acquired the property. The Court held that the Bank acted in good faith merely in trying to *collect its indebtedness* and that the valuable consideration paid for the mortgage was merely the *cancellation of the debt owing to it by the Western*. See the Court's Opinion (Tr. 106-110, at p. 110), and see Judge Fee's Opinion on Rehearing (Tr. 188-213, at pp. 207-8) where it is said:

"Unquestionably, as appears from the subsequent letter of O'Flynn and other evidence, Western intended to give and the Bank intended to get an unreasonable advantage over other creditors. This constitutes an intent to 'hinder, delay and defraud' other creditors, and a showing of actual fraud in the sense of gross and corrupt motive is not necessary to be shown. Under the language of Title 11, U.S.C.A. Sec. 110, Sub. a(4), if the creditor obtained undue advantage because of the transfer, it is fraudulent, although actual fraud be not shown, and the trustee is entitled to the property.

"The finding of the Referee that the Bank did not purchase these lands in good faith must, in view of the authorities and the evidence, be affirmed. It was in good faith in trying to collect its indebtedness. It may be that every-

one involved believed no adjudication would be entered and that an upturn of values would make the bankrupt solvent, but in each instance events have decreed otherwise.

"The finding of fraudulent intent cuts into clear outline the positions with reference to money expended upon the property by the Bank." (See 44 Fed. Supp., Advance Sheets No. 1, pp. 89, 94, and Tr. 207-208.)

(3) Alleged Facts Based on Rejected Evidence

Many of the statements are based upon rejected testimony attempted to be brought into the case through affidavits accompanying the Bank's motion for a new trial. There is no specification of error charging that the Court erred in rejecting testimony nor does Appellant maintain that the decision should be reversed because of the erroneous rejection of testimony. Error cannot here be charged because the Court refused to give the Appellant's interpretation to the testimony offered as after-discovered evidence on motion for new trial, since the granting or denial of a motion for new trial based on after-discovered evidence is entirely in the discretion of the trial court and is not subject to review by an appellate court (see Discussion this Brief, pp. 30-31 post).

Now for specific examples:

(a) "Western pledged these two notes to Portland Trust Company, predecessor of Lawyers Title and Trust Company, trustee for the holders of Western's outstanding Series C installment bonds. These notes remained so pledged until new collateral was substituted and the mortgage discharged in February, 1932." (App. Br. 4)

These statements do not accurately state the facts, even based on the rejected evidence. The rejected evidence tended to show that the Western's mortgages to the Keystone were placed with a trust company, who thereafter resigned the trust, and that they were then deposited with another trust company and thereafter withdrawn. Had evidence not been rejected by the Referee, the Trustee would have shown, as to this phase, as he was in a position to show, that the latter trust company was also a mere alter ego of the Western controlled by O'Flynn, but, of course, there was no necessity for doing so under the circumstances. Moreover, the devastating fact shown by the Bank's own proffered evidence was that the mortgages claimed to have been substituted on Feb. 13, 1932, for the mortgages satisfied and withdrawn on that date were not executed until Feb. 27, two weeks after the satisfaction and withdrawal of the mortgages on the Ranch, nor were they recorded until May, 1932, three months later. (See Bank's proffered Exhibits 18 to 24 at the hearing before Referee Snedecor.)

(b) "Ochoco thereupon issued its note for \$55,960 to Massachusetts which note was secured by a mortgage on the Russell Ranch, in exchange for which Ochoco received certain assets, including mortgages on properties in Wahkiakum County, Washington, and Bend, Oregon, and these mortgages Ochoco transferred to Western in exchange for Western's satisfaction of the Keystone mortgage on the Russell Ranch. It was this Ochoco mortgage on the Russell Ranch which the Bank was to receive and ultimately did receive as security for its new loan to Massachusetts." (App. Br. 7-8)

As a matter of fact, the testimony showed that the Ochoco did not receive mortgages on properties in Wahkiakum County, Washington, and Bend, Oregon, from the Massachusetts in consideration of the \$55,960.00 note and mortgage to the Massachusetts. The purported minutes of meeting of the Ochoco state that the mortgage was given because of the need by the Ochoco *to borrow money*, and the evidence showed that the Ochoco never did any business, never had a bank account and therefore never had any need for borrowing money (see Ex. 12, Tr. 291, 295). However, all of the Bank's statements above are based on the Appellant's interpretation of testimony *rejected*.

(c) "Appellant put experts to work and found evidence establishing (a) that the Keystone mortgage had been paid prior to the filing of the bankruptcy petition, and (b) that the Keystone mortgage was not in the possession of the bankrupt when the petition in bankruptcy was filed, but was in the possession of the trustee of the bankrupt's bondholders." (App. Br. 12)

We assert, as Judge Fee asserted, that even the rejected evidence does not show that the Keystone mortgages had been paid (Tr. 200). However, this entire statement is based on Appellant's interpretation of the *rejected* evidence.

SYNOPSIS OF DISCUSSION FOLLOWING

I. PRELIMINARY LEGAL DISCUSSION

1. Findings of Fact made by a Referee, affirmed on review by the District Judge, must be treated as unassailable upon appeal, if there be any tes-

timony consistent with the finding.

2. The denial by the trial judge of a motion for a new trial based on newly discovered evidence will not be re-examined by the Appellate Court.

II. QUESTIONS OF JURISDICTION

1. The Bankruptcy Court had summary jurisdiction to determine whether, after the filing of the petition in bankruptcy, the Bank had acquired property possessed by the Bankrupt at such time, and, if so determined, to require that such property be surrendered to the Trustee.
2. The Bankrupt at the time of the filing of the petition possessed the property in the Ranch, since the Keystone was not a claimant holding the Ranch adversely to the Bankrupt.
 - (a) It was the agent of the Bankrupt
 - (b) It was the alter ego of the Bankrupt (Piercing the Veil of Corporate Entity).
3. Keystone was not the holder of an adverse interest or of any interest in the mortgage.
4. Ownership of mortgage indebtedness is constructive possession of property, and if ownership in Bankrupt existed at bankruptcy, summary jurisdiction lies.
5. Possession of the mortgage (document) by Bankrupt was not essential when ownership of mortgage was actually in Bankrupt and stood in its name of record, with no assignment of ownership of record or otherwise to another.
6. Though the Bank may claim to be a bona fide purchaser for value of the Ranch, such claim,

assuming possession of the Ranch was in the Bankrupt at the time of bankruptcy, could not defeat the Bankruptcy Court's jurisdiction summarily to determine such claim.

7. Statements of the Bank that mortgage debt in favor of the Western had been paid, or had no value, or had been discharged by exchange of consideration, are not based on evidence before the Court. However, such questions are ones of fact, certainly not of jurisdiction, and since there was evidence to the contrary, this Court will not review the findings.
8. Drainage District Bonds transferred to Bank in same situation as transfer of Ranch.

III. QUESTIONS CONCERNING IMPROVEMENTS, EXPENDITURES AND RECEIPTS

1. The Bank was not a bona fide purchaser for value.
2. Moneys paid after bankruptcy to another in order to obtain property of the Bankrupt cannot be recovered from the Bankrupt's estate.
3. The Bank, being in unlawful possession of the Ranch, will not be allowed credit for alleged permanent improvements, since it was not a purchaser in good faith without notice and for value.
4. The order concerning rental value of the Ranch merely fixed the value of the use of the Ranch, against which value allowed credits for advances may be offset; and although the determination be res adjudicata between the parties, it is not a judgment enforceable as such without further

court action.

5. Money paid to the Bank for a portion of land sold out of the land unlawfully acquired stands in lieu of the land itself, and the turnover order is proper, where money is still held.

I. PRELIMINARY LEGAL DISCUSSION

1. **Finding of fact by a Referee, affirmed on review by the District Judge, must be treated as unsailable upon appeal, if there be any testimony consistent with the finding.**

This doctrine was announced by the United States Supreme Court before the enactment of the present Bankruptcy Act, and therefore before the present General Orders in Bankruptcy were promulgated, and of course before the adoption of the Rules of Civil Procedure for the District Court of the United States. Rule of Civil Procedure No. 52(a) (made applicable to Bankruptcy matters by General Order No. 37) proclaimed this principle in the form of a Rule.

Said the United States Supreme Court in a decision written by Justice Brown, *Davis v. Schwartz* (1894) 155 U.S. 631, 637; 39 L. Ed. 289, 293:

“As the case was referred by the court to a Master to report, not the evidence merely, but the facts of the case, and his conclusions of law thereon, we think that his finding, so far as it involves questions of fact, is attended by a presumption of correctness similar to that in the *case of a finding by a Referee*, the special verdict of a jury . . . or in an admiralty cause appealed to this court. In neither of these cases is

the finding absolutely conclusive, as if there be no testimony tending to support it; but so far as it depends upon conflicting testimony or upon creditability of witnesses, *or so far as there is any testimony* consistent with the finding, it must be treated as unassailable."

Rule 52(a) of the Rules of Civil Procedure provides

" . . . Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the creditability of witnesses."

General Order in Bankruptcy No. 37, provides:

"In proceedings under this Act, the Rules of Civil Procedure for the District Courts of the United States shall in so far as they are not inconsistent with the Act or with these general orders, be followed as near as may be."

Before the Federal Rules of Civil Procedure were promulgated or became effective (1938), this Circuit Court of Appeals also had occasion many times to apply the principle announced by the Supreme Court in *Davis v. Schwartz* (ante).

Said the late Judge Rudkin in *Hunter v. MacFarland* (1930) 45 Fed. (2d) 994:

"The rule is too well settled to require citation of authority that such a report when approved by the trial court, is conclusive upon the appellate court, unless it appears that there was obvious error in the consideration of the facts, or a misapplication of some rule of law."

The late Judge Sawtelle stated on this Bench the same doctrine from another viewpoint, when he said in *In Re Duffy Players* (1931) 50 F. (2d) 737, 738:

“The foregoing findings of fact by the Special Master and by the court below are based on substantial evidence, and are not to be disturbed by this tribunal.”

And the same eminent jurist expressed again the same thoughts in the case of *Neece v. Durst* (1932), 61 F. (2d) 591, 593.

Judge Wilbur also expressed with brevity and positiveness the doctrine in *Wood v. Naimy* (1934), 69 F. (2d) 892, 895, and in *Swift v. Higgins* (1934), 72 F. (2d) 791, 796, when in the former case, he said:

“We cannot disturb the findings of the Referee approved by the court, there being substantial evidence to support it.”

Judge Garrecht gave like expression in the case of *Clements v. Choppin* (1934), 72 F. (2d) 766, 798, as did Judge St. Sure (sitting as an appellate judge) in *Hill v. Douglass* (1935), 78 F. (2d) 851, 853.

And after the promulgation of the Federal Rules of Civil Procedure, Judge Haney in the case of *Walker v. Lightfoot* (1941), 124 F. (2d) 3, 6, adverting to the Rule 52 (a) and *General Orders in Bankruptcy No.37*, said:

“There was evidence supporting such findings and while there was some contrary evidence, we cannot say such findings were clearly erroneous.”

The expressions of the Courts of Appeals of the other Circuits and of the Circuit Court of Appeals of the District of Columbia are in complete harmony.⁽¹⁾

(1) See *Brannow v. Robbins* (C.C.A.D.C.) 50 F. (2d) 499, 500.
LeBlanc v. Fidelity Tr. Co. (C.C.A. 1st), 65 F. (2d) 442, 443.
In Re Oriel (C.C.A. 2nd), 23 F. (2d) 409, 410.

- Plack v. Banner (C.C.A. 3rd), 121 F. (2d) 676, 678.
Beneke v. Moss (C.C.A. 4th), 46 F. (2d) 948, 949.
Wetzel v. Schaefer (C.C.A. 5th), 124 F. (2d) 308, 310.
In Re Willoughby (C.C.A. 6th), 95 F. (2d) 932, 933.
Springmann v. Gary State Bank (C.C.A. 7th), 124 F. (2d) 678, 680.
Robbins v. Winters Creek Canal Co. (C.C.A. 8th), 109 F. (2d) 849, 851.
Alexander v. Theleman (C.C.A. 10th), 69 F. (2d) 610, 611.

We therefore conclude that the findings sustained and sustained again by the District Court will not be disturbed on appeal, since there was evidence on which to base such findings.

In order to lessen the labor of the Court and to show conclusively that there can be no review of the facts in this case, we shall in an appendix set forth seriatim all the findings of Referee Cannon upon the right of the Trustee to restitution and shall append after each some, though by no means all, of the evidence on which such finding was based.

As to the Findings of Referee Snedecor concerning alleged improvements, such findings were based solely on the uncontroverted testimony of a witness for the Bank, so there can be no question here as to the correctness of his findings adopted as they were by the trial court.

2. The denial by the Trial Judge of a Motion for New Trial, based on newly discovered evidence, will not be re-examined by the Appellate Court.

In *Pittsburgh, Cinn.-St. L. R. R. Co. v. Heck*, 12 Otto 120, 102 U.S. 102, 26 L. Ed. 58-59, Chief Justice Waite said:

“We have uniformly held that as a motion for new trial in the courts of the United States is addressed to the discretion of the Court that

tried the cause, the action of that court in granting or refusing to grant such a motion cannot be assigned for error here."

See also the following:

Del. & H. R. Corp. v. Cottrell (C.C.A. 3rd)
69 Fed. (2d) 195, 198.

Shannon v. Shaffer Oil & Refining Co. (C.C.
A. 10th) 51 Fed. (2d) 878, 881.

Erie R. Co. v. Irons (C.C.A. 3rd) 48 Fed. (2d)
60, 63.

N. Y. Life Ins. Co. v. Seifris, 46 Fed. (2d)
391, 393.

O'Brien v. General Acc. Fire & Life Assurance Corp., 42 Fed. (2d) 48-49.)

Henry v. Postal Telegraph Co., 100 Ore. 179,
187, 197 Pac. 258.

It is of interest to recall Judge Fee's statement in his opinion concerning the tendered "newly discovered" evidence. Said Judge Fee:

"The evidence tendered seems rather to strengthen than weaken the foundation." (Tr. 202)

It follows as a corollary of the law as thus expressed that evidence attempted to be presented as newly discovered evidence for the purpose of persuading the trial court to grant a new trial will not be reviewed by this Court to determine whether the Court exercised its discretion correctly, and certainly cannot be used for the purpose of determining whether the trial court should have originally reached a different conclusion than it did reach when such evidence was not before it.

II. QUESTIONS OF JURISDICTION

1. The Bankruptcy Court had summary jurisdiction to determine whether, after the filing of the Petition in Bankruptcy, the Bank had acquired property possessed by the Bankrupt at such time, and, if so determined, to require that such property be surrendered to the Trustee.

There need be no citation of authorities to maintain the proposition above. Both Referee Cannon and Judge Fee in their respective opinions cited numerous authorities to substantiate a like statement, and Appellant in its Brief (p. 23) now concedes such statement to be the law.

2. The Bankrupt at the time of the filing of the Petition possessed property in the Ranch, since the Keystone was not a claimant holding the Ranch adversely to the Bankrupt.

A. IT WAS THE AGENT OF THE BANKRUPT
(Answering Appellant's Brief pp. 23-24)

The Appellant in its Brief urges that the Keystone held property in the Ranch adversely to the Bankrupt and that since the Bank traces its title through the Keystone, it therefore has the benefit of the adverse position of its predecessor in title. Disregarding for the moment the fact that the Western held a mortgage upon the Ranch for an amount in excess of its value, nevertheless the Bankruptcy Court had jurisdiction to determine the question whether or not one who holds property asserted to be the property of the Bankrupt holds such property adversely or whether it holds the same in the

interest of and as agent of the bankrupt. Of course, it is Hornbook Bankruptcy Law that where at the time of the filing of the petition, property of the Bankrupt is held by another, whom the trustee claimed holds in the interest of the Bankrupt as agent bailee or otherwise, the Court (Referee) has jurisdiction to examine into the claim of that person for the purpose of determining whether such claim is a pretense and therefore merely colorable or whether the claim of the so-called adverse party is really adverse. For the purpose of determining whether summary jurisdiction lies in the first instance, the petition of the Trustee is alone searched. It is for the Court, which includes the Referee, to determine this question. If it determines that the Trustee's petition sets up a case of ownership in the interest of the Bankrupt, it retains jurisdiction. If it finds that it does not, it relegates the parties to a plenary suit. Both Referee Cannon and Judge Fee examined this question with thoroughness. They concluded that the Keystone, under the allegations of the Trustee's petition, was the agent of the Western and was holding the title to the Ranch for the Western and that any claim to the contrary was merely a pretense. Then the Bank filed its Answer and denied, among other things, that Western possessed the Ranch at bankruptcy. It then became the obligation of the Trustee (again for the nonce disregarding the mortgage-ownership) to establish its position that the property was held by the Keystone in the interest of the Bankrupt, and that any adverse claim of interest in the Keystone

was a pretense and merely colorable. Certainly the Court had jurisdiction to determine this question upon the pleadings and the proof.

Said this Court in the late case of *City of Long Beach v. Metcalf*, 103 Fed. (2d) 483, 486:

“Whether the bankruptcy court had jurisdiction of this proceeding must be determined by a consideration of the allegations of appellee’s petition. *Flanders v. Coleman*, 250 U.S. 223, 227, 39 S. Ct. 472, 63 L. Ed. 948. Appellee’s petition alleges that at the date of the filing of the petition in bankruptcy, the property in question was owned by, and was in possession of, the bankrupt. If so, the filing of the petition in bankruptcy brought the property into the custody of the bankruptcy court. *Acme Harvester Co. v. Beckman Lumber Co.*, 222 U.S. 300, 307, 32 S. Ct. 96, 56 L. Ed. 208 (and other cases cited), and, upon adjudication, title to the property, with actual or constructive possession vested in appellee—the bankruptcy court’s trustee—as of the date of the filing of the petition in bankruptcy. *Mueller v. Nugent*, 184 U.S. 1, 14, 22 S. Ct. 269, 46 L. Ed. 405 (and other cases cited).

“Thereafter, notwithstanding Sec. 23, *supra*, the bankruptcy court, having possession of the property, had jurisdiction to hear and determine all questions respecting title thereto. *Murphy v. John Hofman Co.*, 211 U.S. 562, 568, 29 S. Ct. 154, 53 L. Ed. 327 (and other cases cited). Whether such possession was actual or constructive is immaterial. Constructive possession was sufficient. *Taubel-Scott-Kitzmiller Co. v. Fox*, *supra*. We hold, therefore, that the bankruptcy court had jurisdiction of this proceeding. . . .

“Appellants may, in their answer, deny any or all of the appellee’s allegations, including the jurisdictional allegation that the bankrupt was in possession of the property at the date

of the filing of the petition in bankruptcy. Such denial, if made, will place on appellee the burden of proving the challenged allegations.

“If the jurisdictional allegation is proved by appellee or (hereafter) admitted by appellants, the referee should, and we assume that he will, then proceed to hear and determine the other issues raised by the petition and answer. If the jurisdictional allegation is not proved or admitted, the referee should, without considering any other issue, dismiss the proceeding.”

This is an accurate and succinct statement of the law. The allegation of the Trustee's petition clearly stated that the Western was in possession and ownership of the Ranch but that the Keystone held said title “for and on behalf of the said Western Bond & Mortgage Co. as agent, subsidiary and alter ego of said Western Bond & Mortgage Co. and that before and after the filing of the petition in bankruptcy against the Western Bond & Mortgage Co. said Western Bond & Mortgage Co. in truth and in fact owned and was in possession of the fee of said Russell Ranch and owned and possessed said property” (Par. II of the Petition, Tr. 19, 21-22).

The Referee held that such allegation and others in the petition gave the Court summary jurisdiction to hear the matter (Tr. 38-45). The Bank in its petition denied these allegations and the burden was then upon the Trustee at the hearing to prove the same. He amply met this burden.

Upon the evidence adduced, the Referee and the Court concluded that the evidence sustained these allegations. This evidence was not only to the effect

that the Keystone was a wholly owned subsidiary of the Western, but it went much further than that. It showed that when the Keystone acquired title to the Russell Ranch, it obtained same from the Russell Land & Livestock Company (Ex. 15, Tr. 304), another wholly owned subsidiary of the Western (Ex. 7). There is no evidence in the record as to what it paid for the Ranch or that it paid anything for it. Immediately upon its acquisition and simultaneously (Tr. 304) therewith, it executed two notes aggregating \$150,000.00 to the Western, its parent, and gave it a mortgage on the property to secure those notes (Ex. 16, Tr. 304-5). The evidence established that the Ranch property was never worth such sum (Tr. 386). All of the directors and officers of the Keystone were women employees of the Western—in fact were stenographers and clerks, having no executive authority or capacity and receiving no salary from the Keystone. They were in fact dummies to the full extent of that word used in corporate structures. They admittedly used no discretion as directors. They followed explicitly and without question the directions of the President of the Western. What he said, they did, without reasoning why and without objection or hesitancy. They responded to the slightest pull of the string by Western. The Keystone had no office of its own; its office was in the office of the Western. At the time of these transactions, it did no business whatsoever although formerly it had done, on behalf of the Western, a small loan business. The Western made a joint tax return to the federal government, including therein the

Keystone as one of its subsidiaries. No books of the Keystone were available, if any were ever kept; the Keystone made no adverse claim to the property. (For verification of these latter statements see pp. iv-viii Appendix, this Brief.) Therefore, as stated, the Referee and the Judge held that the Keystone was an instrumentality or agency of the Western in the possession of the ranch property. Certainly there was evidence in the record on which to base this finding, and as Judge Fee properly said, there was no necessity here, in order to find actual ownership or lack of adversity, for piercing the veil of corporate entity. The finding that the Keystone was the agent of the Western is amply supported.

B. IT WAS THE ALTER EGO OF THE BANKRUPT
(PIERCING THE VEIL OF CORPORATE ENTITY)

(Answering Appellant's Brief pp. 27-32)

However, if there be need to pierce the veil of corporate entity, the Court was certainly justified in piercing that veil in this instance, especially where it was found not merely that the Keystone was a wholly owned subsidiary of the Western but that it was its alter ego by virtue of the fact that it had no real corporate existence of its own except in form. Its whole activities were directed by puppets of the Western, holding merely qualifying shares in the Keystone. (In its Brief, the Bank repeatedly asserts that the entire ownership of the stock in a corporation will not justify piercing the veil of corporate entity—as though that was the only element present in this case. We agree that

that alone would not, without more, be sufficient. But there was more.)

In our Brief before the trial court we cited from a mass of authorities, twenty-one federal cases decided either by the United State Supreme Court or by the circuit courts wherein the veil was pierced. We shall not attempt to go through that process again. Many cases have been decided since that time to like effect. It will suffice to call to the Court's attention four cases only, three among the twenty-one cited in the court below, and one among the cases recently decided. We quote briefly from these four cases.

In *Chicago, M. & St. P. Ry. Co. v. Minneapolis Civic & Commerce Assn.*, 247 U.S. 490, 38 Sup. Ct. 553, 556-557, it is said:

"The management and control of all the operations of the Eastern Company has always been kept in charge of a 'managing committee' of two members, one of whom for many years before the evidence was taken was the general manager of the Omaha Company and the other the general superintendent of the Milwaukee Company. The Eastern Company did not pay either of these men any salary for their services.

"The auditor of the Omaha Company has been the auditor of the Eastern Company, which paid no part of his salary, and the established practice has long been for the one bookkeeper of the Eastern Company to take his journal and ledger to the auditor of the Omaha Company monthly for verification.

"Seven of the nine directors of the Eastern Company at the time the evidence was taken were officers either of the Milwaukee or Omaha Company; the eighth, the attorney of the Eastern, had desk room in the Milwaukee Com-

pany's legal department, of which he had recently been a member; and the ninth director, the president, was not an employee of either of the two owning companies."

Upon these facts, the Court, through Mr. Justice Clarke, said:

"Much emphasis is laid upon statements made in various decisions of this court that ownership, alone, of capital stock in one corporation by another, does not create an identity of corporate interest between the two companies, or render the stockholding company the owner of the property of the other, or create the relation of principal and agent or representative between the two. . . .

"While the statements of the law thus relied upon are satisfactory in the connection in which they were used, they have been plainly and repeatedly held not applicable where stock ownership has been resorted to, not for the purpose of participating in the affairs of a corporation in the normal and usual manner, but for the purpose, as in this case, of controlling a subsidiary company so that it may be used as a mere agency for instrumentality of the owning company or companies. In such a case the courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require."

In the case of *Clere Clothing Co. v. Union T. & S. B. Co.* (C.C.A. 9th), 224 Fed. 363, Judge Morrow said:

"The Referee in Bankruptcy found as a fact that the Clere Clothing Co. and the Prager-Schlesinger Company were one and the same, the latter being merely an adjunct or instrumentality of the former; that to allow the Clothing Company's claims would be to permit it to

prove debts against itself in fraud of creditors. The claims were accordingly disallowed and rejected. Upon review by the court below the order of the referee was affirmed. . . .

"The fact that the two companies preserved separate entities does not detract in the slightest degree from the force of the facts adduced in the testimony hereinabove referred to."

And in *In re Eilers Music House* (C.C.A. 9th), 270 Fed. 915 (Petition for certiorari denied, 42 Sup. Ct. 55), it was held that subsidiary corporations were so controlled by the dominant corporation, Eilers Music House, who owned most, though not all, of its stock, that the veil of corporate existence would be pierced and that the bankruptcy court would take summary jurisdiction of both concerns, notwithstanding the protest and contest of the subsidiary as an adverse claimant.

In *Stone v. Eacho* (C.C.A. 4th), 127 Fed. (2d) 284, 288-9, Judge Parker says:

"It is well settled that courts will not be blinded by corporate forms nor permit them to be used to defeat public convenience, justify wrong or perpetrate fraud, but will look through the forms and behind the corporate entities involved to deal with the situation as justice may require (citing numerous cases) . . ."

and referring to the case of *In Re Eilers Music House*, he makes this comment:

"In the case of *In re Eilers Music House*, supra, the assets of the subsidiary, which like the subsidiary here had no real separate existence, were ordered turned over to the trustee in bankruptcy of the parent in a summary proceeding upon a notice to show cause; and such a turnover order was approved in *Fish v. East*, 10 Cir. 114 Fed. (2d) 177, 191, and *Tiller Bldg. Co. v. Reynolds* (7th Cir.) 247 Fed. 90."

We also call to the attention of the Court the cases cited by Judge Fee in the notes to his opinion (Tr. 202-203).

Now the Appellant in its Brief (p. 24) maintains that if there exists a fair doubt and reasonable room for controversy as to the validity of the adverse claim, then the court has not summary jurisdiction, and cites three cases as authority for that statement. We deny the correctness of this position, and we deny that the decisions in the cases mentioned make such determination. But be that as it may, here in the case at bar there was no actual adverse holding by the Bank of the property prior to the filing of the petition in bankruptcy. As said in the case of *Adolph Ramish, Inc. v. Laugharn* (C.C.A. 9th), 86 Fed. (2d) 686-688, one of the cases cited by Appellant,

“The transfer to Appellant came after the petition.”

So, too, did it come in the case at bar. Hence no claim of adverse holding can be made by the Bank in its own right. It must, and does now, claim (although such claim was not made below) that it traces its right through the alleged adverse ownership of the Keystone.

But there was no claim of such adverse holding, by *Keystone*. Its President, Miss E. E. Gallagher, was one of the witnesses at the hearing—the only officer of the Keystone, or for that matter of any of the controlled or controlling corporations, to testify. She testified that she, Miss Thibodeaux, Miss Smith and Miss O'Reilly were all the officers and directors

of the Keystone and that there were no other employees of the Keystone (Tr. 303); that they were all office employees of the Western (Tr. 282, 283, 294, 297, 303); that she and Miss Thibodeaux were directors of the Western (Tr. 271, 281); that none of them received any compensation from Keystone; and that none of them had any interest in the Keystone except as a holder of one qualifying share each for which someone else, she did not know who, paid (Tr. 299). She and the other officers and directors of the Keystone acted only to carry out the desires of the president of the Western (Tr. 295). Though president of the Keystone, she could not say or remember whether it did any business whatsoever at or about the time of the transfer of this Ranch, or at any time in 1932. She did not know whether the Keystone was then dissolved. She made no claim or statement that it was holding the property in its own right. Where, then, comes the belated claim by the Bank that its claim of adverseness comes through the adverse position of the Keystone? Certainly there was no evidence presented to show that the Keystone was holding adversely, and all the evidence was to the contrary.

In Appellant's Brief on pages 26 and 27, it stresses its position that any contested matter is an adverse matter, saying

"Appellee will deny that the Keystone's title was adverse. This very denial, however, entitled the Bank to a plenary trial before a court or jury since the issue, upon the facts already stated, indisputably constitutes 'a contested matter of right involving some fair doubt and reasonable room for controversy' " (p. 27).

This argument is, indeed, fallacious for if it is taken to be true, no summary proceedings could ever be maintained where the party against whom it is sought claimed that he has an adverse interest. One may be sure that such a claim would always be made. Thus, summary proceedings could only be brought by consent, which, of course, is not the law. Appellant cites in this connection six cases. We call attention to the fact that in all these cases, the claim which was asserted by the litigant to be adverse was a claim which the *litigant* had acquired *prior* to the filing of the petition in bankruptcy. In this case, possession by the Bank was acquired after the filing of the petition. We tabulate these cases, with data showing that the litigant's possession in every case arose prior to bankruptcy.

Name of Case	Date Possession Taken or Lien Acquired	Date of Filing Petition
In re Club New Yorker, 14 Fed. Sup. 694	Dec. 31, 1935	Jan. 10, 1936
Buss v. Long Island Storage Co., 64 Fed. (2d) 338	Dec. 5, 1930	Approx. 6 mos. thereafter
Mueller v. Nugent, 184 U.S. 15, 46 L. Ed. 411	Feb. 9, 1900	Feb. 19, 1900
Harrison v. Chamberlain, 271 U. S. 191 (1)	Aug. 30, 1917	May 25, 1921
Shea v. Lewis, 206 Fed. 877	Prior to Filing Petition (see Opinion p. 82)	August 9, 1911
Marcell v. Engebretson, 74 Fed. (2d) 93	Feb. 16, 1942	August 9, 1929

Before closing this portion of the Brief, we call to the Court's attention the erroneous statement made on page 27 of Appellant's Brief that, "The

(1) In all the above cases except this one the dates were obtained from the opinion itself, or from the opinion below, but in this instance the source of the dates is the Transcript of Record in that case pp. 1 and 14.

lower court made no finding that Keystone's claim was colorable." We call attention to Findings (3) and (4), (Tr. 71). If these are not findings of fact determining that the Keystone's holding was merely colorable, it would be hard to frame such a finding, except to state in the language of a conclusion that such holding was colorable.

3. Keystone was not the holder of an adverse interest or of any interest in the mortgage.

Nevertheless, even if it be considered that the holding of the fee title to the property by the Keystone was adverse to the Western, which we confidently assert we have shown it was not, and if it be further considered that Appellant's position on that phase is correct, which of course we protest it is not, still there can be no question that the Western at the time of the filing of the petition in bankruptcy held a claim against the Keystone secured by a transfer of property by means of the mortgage to the Western, and that therefore, the Keystone held no adverse or other interest whatsoever in the secured indebtedness *owing by it* to the Western or in the security which it had transferred to the Western by means of the mortgage, and this, irrespective of the fact that the mortgage secured notes in the amount of \$150,000.00, far in excess of the value of the Ranch, found to be of a value of \$65,000.00. So it can be safely premised that the Keystone held no interest adverse to the Western in the mortgage against the property, nor in the debt secured by the mortgage.

4. Ownership of mortgage-indebtedness is constructive possession of property, and if ownership in Bankrupt existed at bankruptcy, summary jurisdiction lies.

(Answering Appellant's Brief pp. 37-41)

Under a preceding heading, we have discussed the question of ownership of the Ranch itself at the time of bankruptcy. Appellant argues that ownership of the mortgage is not ownership of the Ranch property and that in order to recover the Ranch property it is not sufficient to establish the fact that the bankrupt held a mortgage thereon. The position of the Trustee is that ownership of the mortgage indebtedness in the Bankrupt at the time of bankruptcy draws to the Court summary jurisdiction to determine questions concerning that indebtedness and concerning the property held as security therefor to the extent, at least, of the security. It is unquestioned that after bankruptcy the bankrupt destroyed that security and obliterated the indebtedness by satisfying the mortgage and indebtedness of record. It was through the satisfaction of the mortgage which, as stated, was in a value at least equal to the value of the property, that the Bank was enabled to obtain its mortgage upon the Ranch property. Had not the Bankrupt satisfied that mortgage, recorded in its name, the Bank could not have obtained a first lien upon the property through the devious conveyances, mortgages and assignments heretofore referred to. Thus, at the time the Trustee qualified, he would have held, in the interest of

the bankrupt estate, a mortgage against the Russell Ranch securing an indebtedness of \$150,000.00, which he, instead of the Bank, could have foreclosed. It was the acquisition by the Bank of the mortgage, through the recording of the various papers held in escrow with its attorney, including that of the satisfaction, that gave the Bank title through foreclosure. The Bank, therefore, can be required to return that property in a summary proceedings, to the Trustee for the benefit of the creditors. There would be no essential difference in principle if, instead of the devious methods employed, the Bank had taken an assignment directly from the Western of the Keystone's mortgage and notes. Had such been done after bankruptcy, could it be questioned that the bankruptcy court would have had summary jurisdiction to require the Bank to cancel such mortgage, or had the Bank foreclosed thereon, to return the property which it had obtained through such foreclosure?

Aptly did Judge Fee, quoting from *May v. Henderson*, 268 U.S. 111, say in this connection in his opinion (Tr. 205) :

“The Bank, which obtained this asset by whatever devious process, should be required to return it. ‘Any other rule would leave the Bankruptcy Court powerless to deal in an effective way with those holding property for the bankrupt, who, pending the bankruptcy proceedings, wilfully dispose of it by placing it beyond the reach of the court.’ *May v. Henderson*, *supra*, 118.”

It has been often determined by various courts throughout the federal judicial system that notes,

bonds, accounts, stocks, rights to seats on stock exchanges, and other choses in action owned by the Bankrupt at the time of filing the petition are in its constructive possession and are brought into the jurisdiction of the bankruptcy court.

From the mass of such authorities we choose quotations from seven, among them one from the Supreme Court and two from this Circuit.

In *Acme Harvester Co. v. Beekman Lumber Co.*, 222 U.S. 300, 22 Sup. Ct. 96, 99, 56 L. Ed. 208, Justice Day said:

“There is no dispute upon the record that the money attached *was owing to the bankrupt*, and was unquestionably its property. . . . The exclusive jurisdiction of the bankruptcy court is so far in rem that the estate is regarded as in custodia legis from the filing of the petition.”

In *In Re Ransford* (C.C.A. 6th), 194 Fed. 658, 663, the Court says:

“The title to the indebtedness of the bank was in the trustee (*Acme Harvester Co. v. Beekman Lumber Co.*, 222 U.S. 300, 32 Sup. Ct. 96, 56 L. Ed. 208), and we think for the purposes of this suit should be regarded as constructively in his possession, and that the District Court had jurisdiction to proceed summarily to determine the rights of the parties.”

In *In re Orinoco Iron Co. v. Metzel* (C.C.A. 6th), 230 Fed. 40, 44-45, it is said:

“Was the fund in question in the custody of the bankruptcy court? The rule which gives the bankruptcy court exclusive jurisdiction to determine claims to property in its custody is not limited to actual possession, but extends to constructive possession as well, including

property held not only by but for the bankrupt (citing numerous cases). And we have held that a debt due the bankrupt's estate is so far constructively in the trustee's possession as to give the bankruptcy court jurisdiction to determine the rights of parties to it. *In re Ransford*, 194 Fed. 658, 664, 115 C.C.A. 550."

In *In re Worrall* (C.C.A. 2nd), 79 Fed. (2d) 88, 89, it is said:

"The decisions are numerous that, if the bankrupt remained the legal owner of the chose in action up to the time of the filing of the petition . . . his control was such that a trustee in bankruptcy who succeeded him was to be regarded as in 'possession' of the chose in action and as in a position summarily to determine his rights as against other claimants."

And in *In re Borok* (C.C.A. 2nd), 50 Fed. (2d) 75, 79, it is said:

"One cannot speak of 'possession' of a chose in action in the same sense as of tangibles, but if such terminology is to be used, it would seem that the bankrupt was as much in possession of the assigned accounts as he could be of any chose in action."

Said Judge Wilbur in *Seattle Curb Exchange v. Knight* (C.C.A. 9th), 46 Fed. (2d) 34, 35:

"The question involved on this appeal is whether or not the right to the proceeds of the sale of the seat in the Seattle Curb Exchange, as between the trustee in bankruptcy and the Seattle Curb Exchange, must be litigated in the bankruptcy court to the exclusion of the state court. This turns upon the primary question as to whether or not the seat came into the custody of the bankruptcy court at the time of the filing of the petition of bankruptcy or of the adjudication of bankruptcy. That question was carefully and exhaustively considered by Judge

Lurton, then of the Circuit Court of Appeals of the Sixth Circuit, in *O'Dell v. Boyden*, 150 Fed. 731, 736, 10 Ann. Cas. 239. In that case it was said:

“The “seat” or “membership” continued to be the “seat” of Henrotin (one of the bankrupt partners), and was a pecuniary asset which passed to his trustee. It was as much in his custody and possession as such a species of property is capable of. To deny the trustee’s possession would be to deny the capability of possession of a chose in action or other incorporeal right or equity. The possession may be constructive, and not manual; but it is only so because such property is not capable of a more tangible custody.’”

In *Street v. Pacific Indemnity Co.* (C.C.A. 9th, 61 Fed. (2d) 106, 107-109, Judge Sawtelle said:

“The appellant contends that at the time of filing the petition in bankruptcy the money here sought to be recovered by the trustee was in the possession of the county of Alameda, being held for the account of the bankrupt, and therefore in the constructive possession of the bankruptcy court and subject to the summary jurisdiction thereof. It is his contention that the money was paid by the county to appellee pursuant to the assignment . . . nine days after the filing of the petition in bankruptcy, at which time the money was already in custodia legis, and therefore could not be affected by said assignment.

“The authorities are clear that the summary jurisdiction of the bankruptcy court attaches at the time the petition in bankruptcy is filed (citing numerous cases). It therefore becomes necessary to determine the status of the money herein involved at that time. . . .

“The \$6,327.07 . . . held by the county . . . at the time the petition was filed, came within

the constructive possession of the bankruptcy court and subject to its summary jurisdiction. If it were possible to take away that summary jurisdiction by merely turning the property over to one who has a claim against it, the administration of bankrupts' estates would be greatly retarded and unduly hampered."

We assert, therefore, that whether or not the Bankrupt at the time of bankruptcy had possession or ownership of the Ranch property itself through its agent or alter ego, the Keystone, it certainly had possession of the indebtedness against the Ranch secured by the mortgage, and having possession thereof, the Court had summary jurisdiction to place the Bankrupt, as nearly as practical, in the same status as it was at the time of bankruptcy.

- 5. Possession of the mortgage (document) by Bankrupt was not essential when ownership of mortgage was actually in Bankrupt and stood in its name of record, with no assignment of ownership of record or otherwise to another.**

(Answering Appellant's Brief p. 42)

Appellant in its Brief says that in 1931 the mortgage had been pledged by the Bankrupt to the Portland Trust Company as security under a trust indenture to secure outstanding bonds of the Bankrupt and that it so remained until the transaction complained of. There is no evidence in the record on which to base a statement, except the Bank's interpretation of the rejected evidence. Had not this evidence been properly rejected, the Trustee, as heretofore stated, would have introduced evidence showing that this Company did not hold such mort-

gage document but that it was supposedly held by a company called the Lawyers Title and Trust Co., an organization entirely owned and controlled in the interest of the Bankrupt, that there was no trust indenture of record and that the so-called bonds which were claimed to have been secured by this fictitious deposit of the document were merely certificates of indebtedness held by creditors, most of whom had filed their claims in the bankruptcy proceedings. But such course was not necessary.

Be all that as it may, however, the controlling devastating fact remains that the Western had sufficient possession of the mortgage to satisfy the same of record and to satisfy the obligation which it secured. Possession in a bankrupt at or after bankruptcy sufficient to surrender property is certainly sufficient to give the court jurisdiction over the property surrendered after bankruptcy.

Moreover, it is provided under the Oregon statutes, as follows:

Section 70-127, O.C.L.A.:

“Separate books shall be provided by the County Clerk in each county for the recording of deeds and mortgages.”

Section 70-130, O.C.L.A.:

“Every conveyance affecting the title of real property within this state hereafter made which shall not be recorded as provided in this title shall be void as against subsequent purchasers in good faith and for a valuable consideration. . . .”

Since the Trustee in bankruptcy, under the Bankruptcy Act, is in the position of a bona fide pur-

chaser for value, the mere possession of a mortgage document by another is ineffective and void as against a Trustee in bankruptcy.

If the rejected evidence be considered, which we insist it cannot be, still the facts in the case of *In re Bastanchury Corp.*, 62 Fed. (2d) 537, 542, cited by Appellant at p. 42 of its Brief, are of an entirely different nature. There, after default, a Trustee under a trust indenture took possession of the property in the interest of the beneficiaries of the trust on January 25, 1932, and at the time of bankruptcy, March 21, 1932, was holding and operating said property (see page 538 of the decision). The Trustee in that case claimed that the Bastanchury Corp. was holding as agent of the Bankrupt, since under California law a Trustee in a trust indenture is agent for both the Trustee and the beneficiary. But the Court held that such position was subject to qualification, that is to say, that until default he might so hold, but that after default, he holds in the interest of the beneficiaries, at least until the indebtedness to the beneficiaries is satisfied. There default had occurred. It was in this connection that the Bank said that a real controversy in law existed and that there was at the least a "fair doubt and reasonable room for controversy as to the validity of the adverse claim." So we see merely that where *prior* to bankruptcy possession was taken by the litigant under a right which the Court held was probably sustainable, that the matter should be relegated to a plenary suit.

6. Though the Bank may claim to be a bona fide purchaser for value of the Ranch, such claim, assuming possession was in the Bankrupt at the time of bankruptcy, could not defeat the Court's jurisdiction summarily to determine such claim.

(Answering Appellant's Brief pp. 32-37)

So startling is the Appellant's assertion that the mere claim that it was a bona fide purchaser of the property after bankruptcy defeats summary jurisdiction, that we have read and reread this portion of the Brief to discover if we may not have misinterpreted the Appellant's position.

There is no such law. Given the fact that the Bankrupt had possession of the property at the time of bankruptcy, the claim that the litigant was a bona fide purchaser after bankruptcy is determinable in a summary proceeding. Of course, if the bankrupt did not have possession of the property in question at the time of bankruptcy, then the litigant was or was not a bona fide purchaser, no such summary jurisdiction would exist. If the mere claim that one is a bona fide purchaser would defeat jurisdiction over property owned by the Bankrupt at the time of bankruptcy, then Bankruptcy Courts would be impotent to administer bankrupts' estates and would be at the mercy of anyone who could grab the bankrupt's property before a Trustee was appointed, claiming thereafter to be a bona fide purchaser of it. Thus would the Trustee be forced into plenary suits to bring back to the Bankruptcy Court property which it had in its jurisdiction upon the filing of the petition.

Obviously, the Bank has little confidence in its

assertions that the mere *claim* of bona fides is sufficient to defeat summary jurisdiction since it indulges in three pages of argument (pp. 35-37) in the endeavor to show that it established in the court below that it actually was a bona fide purchaser. The Bankruptcy Court three times (two Referees and the Judge) found, after examining the evidence, it was not. If the mere claim of bona fides were sufficient to defeat jurisdiction, the matter ends; if not, then the determination made by the Referees and the Judge will not here be reviewed, since such finding was made upon substantial evidence. (We shall discuss the factual question of bona fides in a later portion of this Brief, pp. 63 to 72.)

The Appellant discusses at pp. 33-34 of its Brief, the case of *Morrison v. Bay Parkway National Bank* (C.C.A. 2nd), 60 Fed. (2d) 41, and cites six other cases (at p. 34) claimed to be of like effect in substantiation of the proposition that where a litigant claims to be bona fide purchaser of the Bankrupt's property after bankruptcy from one other than the Bankrupt, summary jurisdiction will not lie. The cases do not so hold.

In the *Morrison v. Bay Parkway National Bank* case, *supra*, one Zalta was adjudicated bankrupt on July 21, 1930. The Trustee, Morrison, brought suit against the Bay Parkway National Bank to set aside a preference given within four months prior to the filing of the petition in bankruptcy and recovered a judgment against the Parkway Bank for the recovery of that preference. Sometime after the adjudication in bankruptcy, the Lafayette National

Bank purchased the Parkway Bank, and assumed to pay all the debts of the Parkway Bank. The Lafayette Bank had no notice of the Trustee's claim or its suit against the Parkway Bank. The Trustee sought, in a summary proceedings, to recover *from the Lafayette Bank* the preference which the bankrupt, Zalta, four months prior to the filing of the petition in bankruptcy had by payment given *to the Parkway Bank*. The Trustee maintained, first, that in view of the fact that the Lafayette Bank had assumed to pay all the indebtedness of the Parkway Bank, the adjudicated preference given by the bankrupt Zalta to the Parkway Bank was assumed. The Trustee further maintained that he, having obtained judgment for recovery of this preference given by Zalta to the Parkway Bank, and the Lafayette Bank, having received the assets of the Parkway Bank, it could follow those assets in the hands of the Lafayette Bank. The court held that a Trustee could not recover in a summary proceedings upon a breach of contract, even if the contract had been assumed by the transferee of a preferred creditor who had received the preference prior to bankruptcy, nor could the Trustee recover even if the specific funds of the Parkway Bank were traceable in the hands of the Lafayette Bank, particularly where the Lafayette Bank was a bona fide purchaser of the assets of the Parkway Bank without notice of any claim on the part of the Trustee. (The Parkway Bank was not the bankrupt.)

From these facts it will be seen that whatever claim the Trustee in bankruptcy had against the Lafayette Bank, he had by reason of a transfer or preferential payment which had occurred within four months prior to the filing of the petition. Under such circumstances, it is not maintained, and could not be maintained, that a summary suit would lie for the recovery thereof. As the Court very aptly said

“Zalta is not shown to have had any property in the hands of either Bay Parkway Bank or the Lafayette Bank at the time the petition in bankruptcy was filed.”

The quotation made from that case, therefore, on pages 33 and 34 of the Appellant's Brief must be taken and read in the light of the facts.

The case of *Myers v. Hazzard* (C.C. Neb.), 50 Fed. 155 is not a decision concerning summary jurisdiction or jurisdiction at all. The facts in this case are as follows:

George Hazzard, the bankrupt, was at the time of his bankruptcy the owner of an interest in cattle held in the name of Foster & Struthers, and which Foster & Struthers had mortgaged to John Hazzard to secure a number of negotiable notes with the understanding that he would negotiate the notes, and out of their proceeds, pay certain prior encumbrances. He sold the notes to one Coates who was a bona fide purchaser of said notes before maturity and without notice, and the court merely held that the bona fide purchaser of a negotiable note prior to maturity acquired rights under a mortgage which was given to secure that note superior to those of

a Trustee in bankruptcy of the beneficial owner of the chatels mortgaged. The court determined from the facts presented that Coates was a purchaser in good faith, for present consideration, of the notes in question and that having no actual knowledge of the filing of the petition in bankruptcy against Hazzard, that he was also a purchaser without notice. The Court in this case also held that:

“At the time of the assignment of the notes and mortgage to Coates, the mortgaged property was not in custodia legis.” (p. 163)

(We also call attention to the Court that this decision under the Bankruptcy Act of 1867 which did not give the summary jurisdiction to the Bankruptcy Court given under the present act.)

And so in *In re Mullen* (D.C. Mass.), 101 Fed. 413, the facts are that in 1892 Mullen transferred to his wife certain property. Six years thereafter the wife died, and one year after that Mullen filed a petition in bankruptcy. Two days after the filing of the petition, and in fact after the adjudication, for the petition was a voluntary one, the Continental National Bank to which Mrs. Mullen owed money, sued her Administrator and attached the real property in question and thereafter judgment was obtained and the property levied upon. The Trustee in bankruptcy brought summary proceedings against the Continental Bank to require it to reconvey the property to the bankrupt estate. Upon objections filed in the summary proceedings, the Referee overruled such objections and when the matter came up for review before the court, the court disapproved of the method of thus deter-

mining the case, indicating that the Referee should have also found upon the merits, and said:

“As, however, all parties are desirous that the questions of law should now be settled and as *it lies in my discretion* to pass upon them at this time, I shall not send the case back to the Referee for further hearing.”

From this remark it is obvious the court had determined that summary proceedings would lie, or otherwise it could not send the case back to the Referee for further hearing. The case was heard upon its merits by the court in a summary proceedings. The court merely held that since the conveyance to the wife had been made more than four months prior to the filing of the petition in bankruptcy, the right of an attaching creditor against the property was superior to that of a Trustee in bankruptcy. At that time, the Trustee's rights were those *only* of the bankrupt's creditors, which, under the law of Massachusetts, were inferior to the rights of a prior attaching creditor of the fraudulent grantee, who had no notice of the fraud or of the bankruptcy proceedings. However, it may be said in passing that had this suit been brought after the amendment of 1912 to Sec. 47(a), the Trustee would have prevailed, because under that amendment the Trustee is vested with all rights, remedies and powers of a judgment creditor holding an execution duly returned unsatisfied. So, the decision in that case is merely and only to the effect that under the law as it stood in 1900 the attaching creditor of a fraudulent grantee had superior rights under Section 70(e) to those of a Trustee in bankruptcy, which the

amendment of 1910 attempted to remedy.

The case of *Paddock v. Fish* (D.C.S.D.N.Y.), 10 Fed. 125, also arising under the Bankruptcy Act of 1867, is not a decision in any manner upon jurisdiction, summary or otherwise, and it merely determines the right of a trustee in bankruptcy under the restricted Act of 1867 where property is alleged to have been fraudulently conveyed prior to bankruptcy.

The case of *Bennett v. Semmes* (D.C.E.D. Ark.), 287 Fed. 745, is a plenary suit brought by the Trustee in bankruptcy to set aside a trust deed given within four months *prior* to bankruptcy to secure notes of the bankrupt. There is no question in the case of jurisdiction, summary or plenary. The case is one which was essentially determined by the Uniform Negotiable Instrument Law.

Neither the case of *Gray v. Breslof*, 273 Fed. 526, nor the case of *Peninsular Bank v. Wolcott*, 232 Fed. 68, involves the question of jurisdiction and both were cases brought to set aside preferential transfers given within four months prior to bankruptcy.

We assert, therefore, with positiveness that the claim that one is a bona fide purchaser for value of the Bankrupt's property acquired after bankruptcy is a matter to be properly determined in a summary proceedings upon the facts presented. As heretofore stated, the facts were presented in the summary proceedings and the Referees and the Judge all held that the Bank was not a bona fide purchaser. This should end the matter so far as

that phase of the case is concerned, since there was substantial evidence below on which to base such finding.

7. **Statements of the Bank that mortgage debt in favor of the Western had been paid or had no value, or had been discharged by exchange of consideration, are not based on evidence before the Court. However, such questions are ones of fact, certainly not of jurisdiction, and since there was evidence to the contrary, this Court will not review the findings.**

(Answering Appellant's Brief pp. 42-47)

The Appellant in its Brief under heading "C-3, 4 and 5) bases its statements and arguments almost entirely upon rejected evidence. The flimsy post mortem attempt to show that the mortgage had been paid resulted in the rejection by Referee Snedecor of the proffered evidence. Again, where such evidence was submitted through affidavits upon motion for rehearing, Judge Fee, though holding that the Bank was precluded by laches from petitioning for a rehearing, did consider the so-called newly discovered evidence, part of which concerned that of the alleged payment. Said the Judge in this connection:

"The newly discovered evidence, which it is claimed indicates that the mortgages were paid in full by Western, is unsatisfactory. Even if the money went into the account of a subsidiary, it is clear Western had full control of such accounts and withdrew from them at its pleasure. Besides, there is no showing that these amounts were paid in satisfaction of the mort-

gages. Western left the mortgages in the trust account after it is claimed they were paid." (Tr. 200)

But we insist that such evidence, however flimsy, is not in this case, since it was presented on motion for a rehearing which motion was denied. (See pp. 30-31 ante, this Brief.)

The same remarks are applicable to the claim by the Bank that if the mortgage existed at all and had value, it was exchanged for consideration of equal value. Evidence was attempted to be introduced that the Western had received after bankruptcy other mortgages in consideration for the mortgage which it satisfied in order to give the Bank title. This so-called newly discovered evidence was likewise rejected by Referee Snedecor, and such evidence when presented upon motion for new trial was held by Judge Fee of no weight. (See Trustee's Ex. 18-C (Tr. 593).) Moreover, as to the preposterousness of the claim of the Bank, we recall to the Court's attention that the satisfaction by the Western of the mortgage upon the Russell Ranch was executed the 13th day of February, 1932, and on that day placed in escrow with the Bank's attorney (see Trustee's Ex. 17, Tr. 305, and Trustee's Ex. 24, Tr. 314-315). The Bank's tendered exhibits 18 and 23 are two mortgages in the forms of deeds securing notes of \$225,000.00 executed by the Realty Securities Co. to the Ochoco Farms Corporation upon real property in Wahkiakum County, Washington, and Bend, Oregon. They are signed in the name of the Realty Securities Co. by E. E. Gal-

lagher, President, and B. O'Reilly, Secretary, of whom much has heretofore been said. Both of these mortgages are dated February 27, 1932, and show recordation on May 12, 1932. The Bank's tendered exhibits 22 and 24 show an assignment of these mortgages to the Western by Ochoco, dated likewise on February 27, 1932 and show recordation on May 12, 1932. They, too, are signed in the name of the Ochoco by E. E. Gallagher, President, and B. O'Reilly, Secretary. It will therefore be noted that the satisfaction of the mortgage which the Bank claims was traded for the assigned mortgages of the Realty Securities Co. antedated by two weeks the execution of such assigned mortgages, and by three months their recordation. In other words, it is obvious when the Western satisfied its mortgage upon the Russel Ranch, the mortgages which the Bank claims were traded for such satisfaction were not even in existence. This, to say nothing of the fact that the pleadings and order in the same bankruptcy matter against another claimant tendered by the Trustee (Ex. 18-C, Tr. 593) showed that the property on which the Realty Securities Company's mortgages were given were in the process of foreclosure for taxes far in excess of any value of the property, and that the Court found in that matter that the mortgages of the Realty Securities Co. had no value. We recite these facts not because they have any bearing in this matter but to show the deceptive character of the so-called newly discovered evidence. In disregarding the proffered evidence, well did Judge Fee remark that "The fictitious nature of the

entire transaction is obvious.”

Be all this as it may, however, we again revert to the statement that this proffered evidence was rejected by the Referee and that a new trial based thereon was denied by the Court. It therefore cannot properly be considered by this Court in this case.

Under Appellant’s heading “C-5”, it is stated that “We have presented the issues on the assumption that the [rejected] evidence is properly before the Court”. Our only comment upon this is that undoubtedly the assumption is entirely erroneous. We again refer to the discussion in this Brief, pp. 30-31 ante.

8. Drainage District Bonds transferred to Bank in same situation as transfer of Ranch.

We will not take valuable space in this Brief to discuss this phase. We assert that the bonds, after bankruptcy, were in the possession of the bankrupt, and that, through the fictitious Ochoco, were transferred to the Bank. It is in the situation of the Ranch, except here there is no question of agency or alter ego of Keystone.

III. QUESTIONS CONCERNING IMPROVEMENTS, EXPENDITURES AND RECEIPTS

1. The Bank was not a bona fide purchaser for value.

We now approach that phase of the matter involving Referee Snedecor’s findings and Judge Fee’s adoption thereof.

No question of jurisdiction is here involved. The consideration of the question of the allowance of a credit to the Bank for expenditures for improvements, taxes, rental of grazing lands and even of the payment of moneys to the Massachusetts—if the latter is here involved at all—depends upon a determination of whether or not this Court will review the findings of Referee Cannon and of Referee Snedecor, both approved by the Judge, to the effect that the Bank was a purchaser in good faith, without notice, and for valuable consideration, that is to say, a bona fide purchaser. We therefore discuss this question first.

Referee Cannon found in this regard:

“That . . . the Western Bond & Mortgage Company, without receiving any consideration therefor released and satisfied the said mortgages which it held against said property.” (Finding 9, Tr. 74.)

See also Finding 13, Tr. 76-77.

“That no present consideration, fair or otherwise, was paid by the Bank of California, National Association, for the said Russell Ranch or for the said Drainage District Bonds.” (Finding 20, Tr. 79.)

“That the Bank of California, National Association, had actual knowledge . . . of the filing of the petition in bankruptcy against the Western Bond & Mortgage Company and had actual knowledge . . . of the ownership by the Western Bond & Mortgage Company of the . . . mortgages upon said Russell Ranch to secure the payment of said notes and of the recordation thereof . . . and that the recordation of the satisfaction of the mortgages . . . would deprive the Western Bond & Mortgage Company of its property rights in said Ranch.” (Finding

16, Tr. 77-78)

"That the estate in bankruptcy of the Western Bond & Mortgage Company was diminished to the extent of the value of said Russell Ranch and of the value of said Bonds and that said diminution occurred after the filing of the petition in bankruptcy to the knowledge of the Bank of California, National Association." (Finding 19, Tr. 79.) See also Finding 17, Tr. 78-79.

"That said transactions . . . was . . . out of the ordinary course of business of said Western Bond & Mortgage Company and of said Bank of California, National Association." (Finding 21, Tr. 79)

"That the acquisition of said property . . . by the Bank of California, National Association, was a fraud upon the creditors of the Western Bond & Mortgage Company and a fraud upon the bankruptcy estate of said Western Bond & Mortgage Company." (Conclusion of Law No. (3), Tr. 80)

Referee Snedecor found:

"The Bank was not an innocent purchaser of the Ranch for valuable consideration and without notice of any infirmity in the title it acquired." (Finding 13, Tr. 134)

"The Bank knew that the grantor's capacity to execute a valid conveyance was in litigation. The Bank, in an attempt to obtain an advantage over other creditors, acted before that litigation was concluded. The Bank knowingly took the obvious chance that the conveyance might be defeated by the subsequent adjudication of the grantor, and with this knowledge, proceeded to treat the property as its own. In the opinion of the referee this is not the 'good faith' which should impel a court of equity to protect the Bank." (Finding 17, Tr. 137)

"The Bank of California, N.A., did not purchase the Russell Ranch in good faith and therefore it should not be permitted to recover the

value of any improvements made by it." (Finding 19, Tr. 139)

Judge Fee approved Referee Cannon's Findings and confirmed those of Referee Snedecor. In his opinion in the case, among other things, Judge Fee said:

"The Bankrupt received no present consideration for the removal of this asset." (Tr. 205)

"It must be kept in mind that all the dealings of the Bank with this property took place after the filing of the petition *and notice* of the fact to the Bank. Unquestionably, as appears from the subsequent letter of O'Flynn and other evidence, Western intended to give and the Bank intended to get an unreasonable advantage over other creditors. This constitutes an intent to 'hinder, delay and defraud' other creditors, and a showing of actual fraud in the sense of gross and corrupt motive is not necessary to be shown. . . .

"The finding of the referee that the Bank did not purchase these lands in good faith must, in view of the authorities and the evidence, be affirmed. . . .

"The finding of fraudulent intent cuts into clear outline the positions with reference to money expended upon the property by the Bank." (Tr. 207-208)

The testimony on which *lack of consideration* was based came largely from the books and from the testimony of a certified public accountant who examined the same and who testified that he found "no record of any consideration being paid." (Tr. 331-333)

The testimony on which *notice* was based came in part from the attorney for the Bank, Mr. Thos. Greene, and in part from the credit files of

the Bank. The Attorney testified that he had knowledge of the filing of the involuntary petition in bankruptcy against the Western prior to the transactions here involved (Tr. 251) and that the Bank had all the information that he had (Tr. 369-370). And more than that, Exhibit 31, the credit file of the Bank of California, (Tr. 414) shows that under date of 11/28/31 there was entered a memorandum from the Daily Journal of Commerce as follows:

“Western Bond & Mortgage Company—Involuntary Bankruptcy.”

Moreover, in said file there appears a communication addressed “To Bank of California (see its reverse side) from Bradstreet Co. dated May 27, 1931, reporting as follows:

“Re: Western Bond and Mortgage Co.

“An involuntary petition in bankruptcy was filed in the federal court November 25, 1931, against the above company. Petitioners are: Warren Hardy, Attorney of Seattle, \$500.00; D. R. Potter, Prineville, Oregon, \$90.00; and Vincent & Vincent, Portland, Oregon, \$75.00.”

Testimony concerning knowledge by the Bank of the Western's ownership of the Keystone notes and mortgage was supplied by the Attorney for the Bank who had the abstract of title and who examined the same. Asked directly whether he knew that the property on which the Bank was about to take a mortgage was property that the Western held mortgages on at the time, he answered:

“How could I help knowing it when the abstract showed it. Of course I knew it.” (Tr. 267)

Likewise, Mr. Greene testified that he had knowledge of the transfers, satisfactions, mortgages and assignments involved herein (Tr. 256-261). It also appeared from the evidence that the Bank had actual knowledge of the ownership by the Western of all the stock in the Keystone (Exs. 30 and 31, Tr. 413-414). Moreover, Mr. Greene, prior to the filing of the petition in bankruptcy, had heard charges made in a trial against the Western which he attended that the Keystone was a mere dummy of the Western (Tr. 402-404). It also appeared in evidence that the Bank had knowledge of the ownership of all the stock in the Western by the Massachusetts (Tr. 349). It also appears from the testimony that Mr. Greene, the attorney for the Bank, holding in escrow the deed, satisfactions, assignments and mortgages involved in the transaction, must have known the interlocking character of the officers of the various corporations, because in most of the instruments the officers signing them, even when conveying from one corporation to another, were the same.

Lack of good faith is also implicit in the evidence. The very deviousness of the process in itself furnishes an inference from which bad faith may be premised. Judge Fee said:

“The Bank which obtained this asset, *by whatever devious process*, should be required to return it.” (Tr. 205)

And again says Judge Fee:

“A valuable asset was transferred to the Bank and taken away from Western and its creditors by the *complicated devices* heretofore outlined.” (Tr. 206)

Another basis for premising bad faith will be, found in a letter written by O'Flynn, President of the Western, to the Bank of California, in reply to a registered letter written by the Bank to Ochoco, care of the Western, demanding the first payment on the note and threatening, unless paid promptly, to declare the whole amount due. O'Flynn interpreted this as a threat to foreclose the mortgage and said:

"A foreclosure can do nothing but give you the property and prevent any efforts on our part to refinance. In addition thereto might I suggest, and this in all good faith and still in the spirit of co-operation, that such an action might not result favorably for the bank, even though it was successful against the Ochoco Farms Corporation. The bank and the Western Bond are *in rather a delicate position* in this matter and it is not certain but what the plans of both of us might not be upset by the misfortune of a foreclosure. It would seem the part of wisdom as well as good business to wait until the determination of the petition in bankruptcy. The longer this matter is postponed the better the position of the Western Bond and the more probable ratification of all that has been done *in the effort of the Western Bond* to protect this account. At this time and for some little time yet it would seem too big a gamble and risk. . . . Everything possible has been done by the *Western Bond* and *your attorney* to protect you in the premises and for our part we will continue but naturally might be handicapped if through some action of your own you disturb a present satisfactory condition and *awaken sleeping forces.*" (Ex. 26-a and b, Tr. 317, 319)—Italics ours.

(See Judge Fee's comments on this letter, Tr. 193)

Moreover, in his report to the Home Office of the Bank of California (Ex. 30, Tr. 413) Mr. Alward, its then Portland Manager, explaining why he had set up an account on the Bank's books under the name of "Westco Finance Co.", a fictitious non-existing company, says:

"This is an unincorporated company set up for convenience in handling the liquidation of assets acquired through the settlement recently made *with the Western Bond & Mortgage Company*. . . . About a year ago it became necessary for us to advance funds for the care of sheep under the mortgages, and it developed that the collateral was entirely inadequate and that a very substantial loss would be faced in liquidation. The Western Bond & Mortgage Company's affairs were not in good shape." (Italics ours.)

And further in the same report Mr. Alward says:

"The first mortgage on the Ochoco Farms Corporation land is, of course, excessive from the standpoint of a conservative loan. . . . This is the most satisfactory *adjustment* that we could make of a *very bad situation*. . . ." (Italics ours.)

There is a further document in this case which speaks loudly of lack of good faith on the part of the Bank in endeavoring to make it appear that there was acquired property from one detached from the bankrupt. We speak of a contract or bill of sale drafted on behalf of the Bank of California for signature by the Western Bond & Mortgage Company (Trustee's Ex. 22). In that contract under a "Whereas" clause, it is set forth that the Western had pledged to the Bank certain property and that the Bank had accepted said property as security.

Then there is a further "Whereas" clause, as follows:

"Whereas, to avoid the expense, cost and delay of a suit by the Bank to foreclose its lien upon and sell the said collateral and other securities to apply on said indebtedness, the Company has proposed to convey the same and all its right, title, interest and equity therein and to the properties represented thereby *and other property* to the Bank in full payment and satisfaction of its indebtedness to the Bank, and the Bank is willing to accept the same, *with other property* in full payment of its indebtedness and to surrender and cancel all its claim against the Company in consideration thereof." (Italics ours.)

Then, in consideration of the property turned over to the Bank, the Bank releases its claim against the Western and the Western further "covenants to and with the Bank that it is the lawful owner of said property." The Western, according to the testimony of the Bank's witnesses, was to do nothing. They were to surrender or give no other property than that which it had previously pledged to the Bank. Is it not apparent that the "other property" was property which the Western had at the time of filing the petition in the mortgages upon the Ranch or in the Ranch itself?

We comment on these documents as evidencing the existence of bad faith, by saying *res ipsa loquitur*.

Pomeroy in his work on *Equity Jurisprudence*, Vol. II, Sec. 745, page 205, says:

"The essential elements which constitute a bona fide purchase are therefore three—a valuable

consideration, the absence of notice and the presence of good faith.” (1)

We insist that the evidence showed unquestionably: (1) that the Bank did not pay a valuable consideration in the eyes of the Bankruptcy Law for the property which it acquired;(2) (2) that it did not act without notice; (3) that it did not act in good faith. We unhesitatingly affirm that this Court will not review the two Referees’ findings in this regard approved as they were on review and on rehearing by the District Judge.

2. Moneys paid after bankruptcy to another in order to obtain property of the Bankrupt cannot be recovered from the Bankrupt’s estate.

(Answering Appellant’s Brief pp. 48-50)

In previous portions of this Brief, we have amply shown that the findings of the Referee approved by the Judge were to the effect that the Western received no consideration whatsoever for the property of which it was denuded, and that there was ample evidence on which to base such finding. The record is replete with the fact that the Bank loaned to the Massachusetts \$20,000.00 or more on the Massachusetts’ own note, covered by collateral security of the Massachusetts, and there is not an iota of evidence that the Massachusetts turned this money over to the Western—in fact, the evidence is to the contrary. In Paragraph IX (Tr. 50) of the Bank’s Answer, the Bank states: that a part of the con-

(1) See also *Houston Oil Co. v. Wilhelmn* (C.C.A. 5th), 182 Fed. 474; *Stonebraker-Zea Cattle Co. v. United States* (C.C.A. 8th), 220 Fed. 99, 101.

(2) Valuable consideration in bankruptcy means, of course, present consideration and does not include satisfaction of a debt.

sideration for the mortgage which the Bank received was "the advance by Respondent (Bank) to or for the account of said Massachusetts Mortgage Co. of the sum of \$28,495.71."

Under what equitable theory then can the Bank maintain that it is entitled to receive from the bankrupt estate this money? There are many cases in the books where one in good faith has acquired property and paid to the owner of the property a sum of money and thereafter, through no fault of his own, he has been required to reconvey the property to the former owner. Under such circumstances, many cases hold the original owner is required to return the consideration which he received for the property. We do not quarrel with the cases cited by Appellant on page 49 of its Brief, for they hold nothing more than just stated. But here we have a different situation, even eliminating, (which of course we do not), the question of notice and of bad faith. Here, the Western received *nothing* for its property. We ask, when, in order to obtain a return of property extracted from a trust estate, was it ever held by any court of justice that a beneficiary is required to pay to one who aided in the extraction a sum of money equal to that paid by the abettor to the extractor?

The Appellant also argues in its Brief that since the veil of corporate entity had been pierced in regard to the Keystone and to the advantage of the Western, it should be pierced as to the Western in favor of the Massachusetts. But we an-

swer: there is no evidence in the record that the Western was operating as a mere dummy of the Massachusetts. Only one element requisite for piercing the veil is here present and that is the Massachusetts' ownership of the Western stock. The Western was a separate business entity conducting its own affairs, as was the Massachusetts. At any rate, it is to prevent fraud that corporate entities are pierced, not to perpetuate it. In this instance, we can conceive of no greater injustice than to require a bankrupt estate to take from its creditors funds applicable to their payment for the purpose of rewarding one who paid money to another to assist in obtaining through manipulation, such bankrupt's property.

Moreover, in the answer of the Bank filed to the petition of the Trustee, there is no claim made for repayment of moneys advanced to the Massachusetts.

May we add again that much of the Appellant's Brief in this connection is taken up with the statement based on evidence endeavored to be introduced before Referee Snedecor, which was rejected by him and which rejection was approved by Judge Fee (Tr. 198).

3. The Bank, being in unlawful possession of the Ranch, will not be allowed credit for alleged permanent improvements since it was not a purchaser in good faith, without notice and for value.

(Answering Appellant's Brief pp. 51-55)

The question of whether or not the Bank may

obtain a credit for improvements made upon the property after it acquired the same is dependent upon whether or not it was a purchaser for value in good faith and without notice. The law is as Referee Snedecor and Judge Fee held it to be, namely, that it is only a purchaser for value and without notice who can be credited for improvements made upon property which it acquired for value in good faith. We shall not burden the Court with a review of the authorities presented by us before Referee Snedecor and before Judge Fee, and we respectfully refer the Court to that portion of Referee Snedecor's report in which he discusses the law in this regard (Tr. 129-141), and to Judge Fee's opinion (44 Fed. Sup., Advance Sheets No. 1, pp. 89, 94-95, Tr. 208-212), and to the authorities which are discussed and cited in these opinions. This being the law, as we maintain it is, then in view of the finding of notice, absence of valuable consideration and lack of good faith, there can be no crediting of the Bank for such improvements.

We call attention to the fact that Referee Snedecor, with the approval of the parties, made a personal inspection of the Ranch (Tr. 117) and found that

“These improvements, while adding to the comforts and convenience of operation of the Ranch, added little to its productive value. They are not the type of improvements that would be made by one holding the land for immediate sale; and the Bank knew that if and when the property was restored to the Trustee, it would be the Trustee's duty to sell it for the best price obtainable.” (Tr. 142)

Appellant claims it spent "more than \$40,586.89 in rental and other charges" (App. Br. p. 55). However, in its Answer, which remained unamended and unsupplemented, the Appellant claimed that it had

"Expended for repairs, painting, construction, fences, upkeep, insurance and taxes necessary for the preservation and maintenance of said property the sum of \$23,350.51, and has produced hay thereon of the value of \$15,560.59, leaving a deficit in operation of \$7789.92, which deficit does not include any charge for supervision or accounting or interest upon the investment." (Par. XIII, Tr. 55-56.)

The Court allowed the Bank \$9,546.38 (Tr. 226).

4. **The order concerning rental value of the Ranch merely fixed the value of the use of the Ranch, against which value allowed credits for advances may be offset; and although the determination be res adjudicata between the parties, it is not a judgment enforceable as such without further court action.**

(Answering Appellant's Brief, pp. 56-57)

Under the Oregon statute (*Oregon Compiled Laws Annotated* 8-206) quoted by Appellant in its brief on page 52 where property is unlawfully acquired, the original owner of the property may recover it, together with damages for its use, in lieu of rental, less the value of permanent improvements placed upon the property in good faith. Obviously, upon the endeavor of the Bank to recover for alleged improvements placed upon the property, it was

necessary and proper for the Court to determine the amount of damages (rental value) suffered by the Bankrupt by the deprivation, against which any credit allowed the Bank might be offset. This the Referee did and the Court approved.

The order in this regard may be assimilated to an order of a Referee upon objection disallowing a claim on the ground that the claimant has received a preference. Of course, on such an order, no execution can issue nor by force of the order alone can any recovery be had of the preference, but the order of the Referee is *res adjudicata* between the parties.⁽¹⁾ And so here, while we admit that no execution may be levied for the recovery of the difference between the rental value as found by the Court and the credit for improvements, nevertheless the order is proper and must be made, certainly where, as here, any credits at all are allowed for advances.

5. Money paid to the Bank for a portion of land sold out of land unlawfully acquired stands in lieu of the land itself, and the turnover order is proper where money is still held.

(Answering Appellant's Brief pp. 58-59)

The testimony will disclose, and it will not be denied, that the Oregon State Highway Commission, in order to obtain a right-of-way over the Ranch for a highway, purchased a portion of the ranch property after bankruptcy from the Bank for the

(1) See *Metz v. Knobel* (C.C.A. 2nd), 21 Fed. 317, 318; *McCulloch v. Davenport Sav. Bank* (D.C. Iowa), 226 Fed. 309; *Lincoln v. Peoples Nat. Bank* (D.C. Mich.), 260 Fed. 422; *Clendening v. Red River Valley Nat. Bank*, 11 A.B.R. 245, 12 N.D. 51, 94 N.W. 90.

sum of \$10,000.00 with the consent of the Trustee, without prejudice to the rights of the respective parties (Tr. Vol. II, p. 478). And it further appears that the Bank made no claim for this \$10,000.00 in the event that it was ultimately determined that the Trustee was entitled to the Ranch. See Tr. Vol. II, p. 469, where the following occurs:

“Mr. Teiser: In addition to that the State paid you \$10,000.00?

Mr. Thompson: The \$10,000.00 we have intact to your credit to go against whatever allowance you are entitled to get.”

Based on these statements, the Referee found (Tr. 128)

“Shortly after these proceedings were commenced by service on the Bank of an order to show cause the State of Oregon acquired from the Bank a right-of-way through the Ranch for a new highway. For said right-of-way the State paid the Bank the sum of \$10,000.00.”

The statement in the Appellant's Brief that the \$10,000.00 paid to it was to reimburse it for damages to improvements on the land taken over by the Commission is not borne out by the testimony of the Bank. There is no evidence in the record establishing such claim. Moreover, in this regard, Mr. Thompson said (Tr. Vol. II, p. 469),

“The pump and engine went together. There were three items the State paid for in addition to the \$10,000.00.”

See also further remarks of the Referee concerning same (Tr. 128).

Assuming the Trustee is entitled to the Ranch,

as we insist he is, the Trustee's right to the \$10,000.00 cannot properly be questioned.

CONCLUSION

We conclude this rather extended Brief with the confident assertion that there is no question of fact here for the Court to review, and that the only questions properly before this Court are those of law, namely: (1) whether or not the Bank acquired *after* the filing of the petition property of *the Bankrupt*, and (2) whether or not improvements and expenditures made by the Bank were of such a nature and made under such circumstances as to entitle the Bank to a credit for the same other than those allowed by the Court. As to these two questions of law, we are equally confident that this Court will not reverse the order of Judge Fee. The conclusions reached, as set forth in his able opinion, reported, as heretofore stated, in 44 Fed. Sup. (Advance Sheets No. 1, p. 89), are we believe unassailable.

Respectfully submitted,

SIDNEY TEISER.

Teiser & Keller.



APPENDIX



APPENDIX

Finding (1)—(Tr. 70)

That on the 25th day of November, 1931, an involuntary petition in bankruptcy was filed in the above-entitled court and cause against the Western Bond & Mortgage Company, an Oregon corporation, and that thereafter on the 24th day of September, 1934, the said Western Bond & Mortgage Company was duly adjudged a bankrupt upon said involuntary petition.

Some of the Supporting Evidence:

“Mr. Teiser: I would like to say at the outset. . . . that it is alleged and admitted in the pleadings that an involuntary petition in bankruptcy was filed. . . . and I take it that it is admitted. . . . that there was an order of adjudication. . . .

Mr. Thompson: No question about that.” (Tr. 249-250)

See also Petition in Bankruptcy (Tr. 2-4) and Adjudication (Tr. 6)

Finding (2)—(Tr. 71)

That the District Court of the United States for the District of Oregon, where said involuntary petition in bankruptcy was filed, had jurisdiction of the subject matter and of the parties in said bankruptcy proceedings and that the adjudication herein was made after hearing, of which hearing all parties to the proceedings had due notice, and were present, and that said adjudication was a valid order of said court.

Some of the Supporting Evidence:

See Petition in Bankruptcy (Tr. 204) ; Subpoena (Tr. 5) ; Return of Service (Tr. 4) ; and Order of Adjudication and recitals therein (Tr. 6-7).

Finding (3)—(Tr. 71)

That at the time of the filing of said petition in bankruptcy against the Western Bond & Mortgage Company, all the capital stock of the said Western Bond & Mortgage Company was owned by the Massachusetts Mortgage Company, a Washington corporation. . . .

Some of the Supporting Evidence:

“Mr. Teiser: I merely wanted to show that the Western Bond & Mortgage Company was owned and controlled by the Massachusetts Mortgage Co.

Mr. Thompson: We will admit it.” (Tr. 269)

See also Exhibit 1 (Tr. 269).

(Testimony of Frederick Greenwood, Manager Portland Branch Bank of California)

“Q. I think you have a statement here that the Massachusetts Mortgage Company owned all of the common stock of the Western Bond & Mortgage Company. You knew that of course, didn't you?

A. Apparently we did, yes.” (Tr. 349)

Finding (3) (Continued)

. . . And that the Western Bond & Mortgage Co. was the owner of all of the capital stock of the Keystone Finance Co., an Oregon corporation.

Some of the Supporting Evidence:

(Testimony of Miss E. E. Gallagher, Assistant Secy. and Director of Western Bond & Mortgage Co., also President of the Keystone Finance Co.)

“Q. I hand you affiliations schedule of income tax return for 1930 of the Western Bond and Mortgage Company and ask you whether or not the signatures attached thereto of W. E. Johnson and E. F. O’Flynn attached are the signatures of these people who were officers of the Western Bond and Mortgage Company?

A. Yes, I recognize the signatures of Mr. Johnson and Mr. O’Flynn.

Q. Were they directors of the Western Bond and Mortgage Company?

A. Yes, they were.

Mr. Teiser: I offer this schedule in evidence with the papers attached to it and call particular attention to the item ‘7’ on the schedule and to item ‘10’, one showing the ownership of all the stock in the Central Realty Company by the Western Bond and Mortgage Company, and the other showing the stock of the Keystone Finance Company owned by the Western Bond and Mortgage Company.

.
The papers were marked Trustee’s Exhibit “7”
(Tr. 277-278)

“Q. I hand you certificates numbered four, nine and ten and eleven, Keystone Finance Company, and ask you whether they exhibit correctly the stockholdings of the Keystone Finance Company in February, 1932?

.
A. This was all of the stock.

Q. These certificates are signed by you as president, are they not?

A. Three are.

Q. The Western Bond & Mortgage Company certificate, number four, is signed by whom?

A. E. Hagenbucker and Miss L. Kelly.

Q. Do you know who they are?

A. They were Massachusetts Mortgage Company employees.

Q. They were office employees?

A. I could not say that without looking it up. They were with the Massachusetts Mortgage Company.

Mr. Teiser: I introduce these four certificates in evidence. They were received and marked as one exhibit, Trustee's Exhibit 14." (Tr. 296-297)

Finding (3) (Continued) (Tr. 71)

. That said Keystone Finance Company was operated and manipulated at all times by the said Western Bond & Mortgage Company as its adjunct, subsidiary and agent and for the sole purpose of carrying out its designs and biddings, and was a mere corporate shell and had no actual existence for its own purposes, but existed solely as a mere agent and alter ego of the said Western Bond & Mortgage Company.

Some of the Supporting Evidence:

(Testimony of Miss E. E. Gallagher)

"Q. Who were the officers (of the Keystone Finance Company) at that time?

A. I was elected president, B. O'Reilly vice-president and Miss Smith assistant secretary.

Q. I think you stated that neither you, Miss Smith or Miss O'Reilly owned any stock in this corporation or had any financial interest in it.

A. No, only we were given a qualifying share.

.

Q. Who did the stock belong to?

A. I never gave it a thought.

Q. Mr. Johnson was president of the Western Bond and Mortgage Company for a while, was he not?

A. Yes.

Q. Mr. O'Flynn was a director and an officer of this company before Mr. Johnson resigned, was he not?

A. Yes. . . . Mr. Johnson was president in January, 1931.

Q. Mr. O'Flynn was secretary-treasurer and a director at that time, January 12, 1931?

A. Yes.

Q. And Mr. Johnson and Mr. O'Flynn continued in those offices until May 2, 1932 . . . ?

A. Mr. O'Flynn became president when Mr. Johnson resigned.

Q. On what date?

A. May 2, 1932.

Q. And you were a director of that company, were you not?

A. Yes. . . .

Q. Where was the office of the Keystone Finance Company in February, 1932?

A. At the Western Bond and Mortgage Company.

Q. And for a time previous to that it was there?

A. . . . It was there for some time previous to that time, yes.

Q. Did the Keystone Finance Company pay any rent for its offices during that period of time?

A. Not as far as I know.

Q. You were president, were you not?

A. Yes.

Q. Were you or any of the other officers of that company paid any salary as officers of that company by the Keystone Finance Co.?

A. No.

Q. Your entire compensation came from the Western Bond and Mortgage Co.?

A. You mean our salary.

Q. Yes.

A. Yes.

Q. In other words, you received no compensation from the Keystone Finance Company?

A. No.

Q. Nor did any of the other officers so far as you know?

A. So far as I know.

Q. Were you and Miss Smith and Miss O'Reilly employees of the Western Bond and Mortgage Company?

A. Yes.

Q. And were there any other employees of the Keystone Finance Company?

A. Not as far as I know.

Q. There was none?

A. No." (Tr. 298-303)

"Q. What positions did Miss Thibodeaux and Miss O'Reilly occupy with the Western Bond and Mortgage Company?

A. They were office employees.

Q. Clerks?

A. Yes.

Q. Stenographers?

A. Yes." (Tr. 294)

"Q. I think you testified you were an office employee of the Western Bond and Mortgage Company and . . . had no financial interest in the company, is that right?

.

A. Yes, I was an office employee and had no financial interest in the company. . . .

.

Q. When you acted as a director of this company . . . by whom were your actions guided?

A. You mean in the work I did?

Q. No, regarding the action of the board of directors; by whom were your actions governed; who directed you what to do?

A. Mr. O'Flynn.

Q. Did you use your own independent judgment or did you follow his suggestions and requests?

A. No, I thought it was my duty to follow anything Mr. Flynn requested." (Tr. 282-284)

Q. Do you know the purpose for which the Ochoco Farms Corporation was formed . . . ?

A. Just as the permit sets forth.

Q. Did Mr. O'Flynn tell you why specifically the corporation was being formed. . . .

A. I can't give any certain words. . . .

Q. Miss Gallagher, I think you stated the directors and officers of the corporation were you, Miss O'Reilly and Miss Thibodeaux?

A. Yes.

Q. According to the minutes there, you were president?

A. Yes.

Q. Miss Thibodeaux was vice-president and assistant secretary?

A. Yes.

Q. And Miss B. O'Reilly secretary and treasurer?

A. Yes.

Q. In the handling of the books of the Ochoco Farms Corporation, by whose advice and direction were you governed?

A. Mr. O'Flynn and Mr. Johnson.

Q. You exercised no independent judgment of your own as to what to do?

A. No.

Q. And is that true of Miss Thibodeaux and Miss O'Reilly? Did they also follow the advice and direction of Mr. Johnson and Mr. O'Flynn?

A. Well, I think they did." (Tr. 292-5)

"Q. Did you follow the same course, you and the rest of the parties, Miss Smith and Miss O'Reilly, in regard to your actions as directors (of the Keystone Finance Co.) as you followed in other corporations which you testified to?

A. Yes.

Q. You and the rest of them acted under the directions of Mr. O'Flynn?

A. Yes, and Mr. Johnson." (Tr. 300)

Finding (3) (Continued) (Tr. 71)

That the officers and directors of said three corporations and of the Ochoco Farms Corporation, hereinafter mentioned, were interlocking.

Some of the Supporting Evidence:

(Testimony Miss E. E. Gallagher.)

See diagram of interlocking officers and directors, p. 11 this brief.

Finding (4)—(Tr. 71-73)

That said Keystone Finance Company at the time of the filing of the petition in bankruptcy herein held title in its name to certain real property in the County of Crook, State of Oregon, known as the Russell Ranch, consisting of some eight thousand acres of land and described as follows:

(Here follows the description)

Some of the Supporting Evidence:

See Exhibit 15 (Tr. 304)

See Paragraph II of Trustee's Petition for Order to Show Cause (Tr. 19, 20) and Paragraph II of Answer of Bank to said Petition (Tr. p. 48) admitting ownership of Keystone Finance Co. in the Ranch.

Finding (4) (Continued) (Tr. 73)

. . . . but that said title was held at all times by it for and on behalf of the said Western Bond & Mortgage Company as agent, subsidiary and alter ego of said Western Bond & Mortgage Company.

Some of the Supporting Evidence:

Reference is here made to testimony recited under evidence supporting Finding (3), pp. iv-viii of this Appendix.

See also Exhibit 7 (Tr. 277-8)

See also Exhibit 14 (Tr. 297)

Finding (5)—(Tr. 73)

That at said time of the filing of the petition in bankruptcy herein, the said Western Bond & Mortgage Company was also the owner of two notes, one in the amount of \$77,500.00 and the other in the amount of \$72,500.00, executed in its favor by the said Keystone Finance Company and secured by first mortgages duly recorded upon the said Russell Ranch in favor of said Western Bond & Mortgage Company, and that said mortgages were first mortgage liens upon said property.

Some of the Supporting Evidence:

See Exhibit 16 (Tr. 304-5)

See admissions in Answer of Bank to Trustee's Petition for Order to Show Cause. (Tr. 48)

Finding (6)—(Tr. 73)

That said Western Bond & Mortgage Company at the time of the filing of said petition in bankruptcy against it was also the owner of twenty bonds of the face value of \$500.00 each of Boundary County, Idaho, Drainage District No. 10, bearing interest at 6 per cent per annum.

Some of the Supporting Evidence:

See Exhibits 22 (Tr. 309), 23A (Tr. 313) and 23B (Tr. 314).

(Testimony of Herbert E. Alward, Vice-President and Branch Manager of Bank of California)

“Q. There was involved in that transaction ten thousand dollars par value of bonds of the Kootenai Irrigation District?

A. Yes.

Q. These were negotiable bonds, were they not?

A. Yes.

Q. They were brought to you by the Massachusetts Mortgage Company?

A. Yes.” (Tr. 367)

See also supporting testimony under Finding 11, post.

Finding (7)—(Tr. 73-74)

That at the time of the filing of said petition in bankruptcy against said Western Bond & Mortgage Company the said Western Bond & Mortgage Company was indebted to the Bank of California, National Association, a National banking organization duly organized and existing under the National

Banking Act of the United States of America, in an amount upards of \$100,000.00, to secure which said Bank of California, National Association, held certain collateral.

Some of the Supporting Evidence:

(*Testimony of R. Erickson, a Certified Public Accountant*)

“Q. There had been loans by the Bank of California to the Western Bond and Mortgage Company of \$103,877.96 and accrued interest, from the books?

A. Yes.” (Tr. 335)

See also Exhibit 28 (Tr. 340)

See also, Paragraph VII of Bank's Answer and Petition of Trustee to Show Cause, admitting indebtedness to it in the sum of \$103,000.00.

(*Testimony of Herbert E. Alward*)

“Q. Did you make efforts that resulted in securing further collateral from the Western Bond and Mortgage Company during the year 1931?

A. Yes.

Q. Tell the court what that was?

A. We secured a deed to some land in Idaho and the assignment of a second mortgage on an apartment house in Seattle, and a number of notes of substantial amount, I have not the figures right in mind, signed by Emery Olmstead secured by some stock. I could tell you a little more about that stock, it was not a very much value.” (Tr. 362)

Finding (8)—(Tr. 74)

That on and prior to the 13th day of February, 1932, the said Bank of California, National Associ-

ation, deemed the collateral and security held by it as insufficient to liquidate said indebtedness.

Some of the Supporting Evidence:

Paragraph VIII of Bank's Answer to Trustee's Petition to Show Cause (Tr. 49) admitting such insufficiency.

(*Testimony of Herbert E. Alward*)

"Q. Thereafter what was your attitude and your efforts towards the Western Bond and Mortgage Company and the new management in the way of liquidating their guarantee on paper?

A. We were continuing with every effort to get the sheep loans in better shape, liquidate them where liquidation was possible, and see that they were properly handled to the end that we could realize everything possible out of the sheep that we had loans on." (Tr. 362-3)

Finding (9)—(Tr. 74)

That thereupon and after the filing of the petition in bankruptcy against the said Western Bond & Mortgage Company, the Massachusetts Mortgage Company and the Western Bond & Mortgage Company caused to be formed a corporation named the Ochoco Farms Corporation under the laws of the State of Oregon.

Some of the Supporting Evidence:

See Trustee's Exhibit 9 (Tr. 284)

(*Testimony Miss E. E. Gallagher*)

"Q. Miss Gallagher, I hand you stock certificate book with stubs and blank certificates and stock certificates of the Ochoco Farms Cor-

poration, of which you were president. Will you state whether or not that is the certificate stock book and the issued stock certificates of that corporation, and all of them?

A. Yes, this is a certificate stock book of the Ochoco Farms Corporation.

Q. And the stock certificates issued?

A. And the stock certificates issued.

Q. Is that all of them?

A. Eight hundred and fifty shares.

Q. Are the certificates which I hand to you with the book, all the stock certificates issued of the Ochoco Farms Corporation?

A. Yes.

Q. You say there were eight hundred and fifty shares?

A. Yes.

Q. And that was the entire issued stock of the Ochoco Farms Corporation?

A. Yes.

Mr. Teiser: I introduce in evidence the stock certificates which have been identified as having been issued. (Marked Trustee's Exhibit 10)

Mr. Teiser: For your information and the information of the Court they were issued one for Miss Thibodeaux, one for Miss O'Reilly, one for Miss Gallagher and 847 to the Massachusetts Mortgage Company. (Tr. 284-5)

Finding (90) (Continued) (Tr. 74)

. . . and caused the Keystone Finance Company

Some of the Supporting Evidence:

See Trustee's Exhibit 19 (Tr. 307)

(Testimony of Miss E. E. Gallagher)

"Q. Miss Gallagher, I ask you to look at this minute book identified as Keystone Finance Company's minute book, and ask you whether

or not the first or top sheet is not the record of a special meeting of the board of directors of the Keystone Finance Company . . . February 11, 1932,

A. Yes.

Q. Were these minutes signed by you as president and Miss Thibodeaux as secretary?

A. Yes.

Q. Of the Keystone Finance Company?

A. Yes.

Q. Was the office in which the meeting was held at the office of the Western Bond and Mortgage Company?

A. Yes.

Q. Pursuant to that resolution this deed which I have already introduced, Trustee's Exhibit 18, signed by you and Miss Thibodeaux for the Keystone Fiance Company was executed, is that right?

A. Yes." (Tr. 306-7)

See, also, supporting testimony under Finding (3) pp. iv-viii this Appendix.

Finding (9) (Continued) (Tr. 74)

. . . . to transfer to said Ochoco Farms Corporation title to the said Russell Ranch,

Some of the Supporting Evidence:

See Exhibit 18, deed from Keystone Finance Co. to Ochooc Farms Corporation of the Russell Ranch. (Tr. 305-6)

Finding (9) (Continued) (Tr. 74)

. . . . and simultaneously therewith the Western Bond & Mortgage Company, without receiving any consideration therefor

Some of the Supporting Evidence:

(Testimony R. Erickson)

“Q. . . . I will ask you whether or not the books show that the Western Bond and Mortgage Company received any consideration from the Keystone Finance Company for the satisfaction of these mortgages?

A. The Western Bond and Mortgage Company received nothing from the Keystone Finance Company to satisfy either of these mortgages.” (Tr. 332)

Finding (9) (Continued) (Tr. 74)

. . . . released and satisfied the said mortgages which it held against said property, thus giving to the Ochoco Farms Corporation the fee simple title to the said Russell Ranch unencumbered by any mortgage liens whatsoever.

Some of the Supporting Evidence:

See Trustee's Exhibit 17, satisfaction of mortgages from the Western Bond & Mortgage Company to the Keystone Finance Co. (Tr. 305)

Finding (9) (Continued) (Tr. 74-5)

That thereupon the Ochoco Farms Corporation executed and delivered to the Massachusetts Mortgage Company a first mortgage upon said Russell Ranch to secure notes aggregating \$55,960.00, thereby supplanting the first mortgages theretofore held by the Western Bond & Mortgage Company.

Some of the Supporting Evidence:

See Exhibit 20, mortgage from Ochoco Farms Corporation to the Massachusetts Mortgage Company (Tr. 307)

Finding (9) (Continued) (Tr. 75)

That the said Massachusetts Mortgage Company thereupon simultaneously assigned said notes, aggregating \$55,960.00, and the mortgage securing the same to the Bank of California, National Association.

Some of the Supporting Evidence:

See Exhibit 21, assignment of mortgage from Massachusetts Mortgage Company to the Bank of California (Tr. 308)

Finding (10)—(Tr. 75)

That the amount of the notes assigned to the Bank of California, National Association, secured by the mortgage, likewise assigned, was the aggregate of advances theretofore made by the Bank of California, National Association, to the Massachusetts Mortgage Company and the amount of the debt owing by the Western Bond & Mortgage Company, after computing and giving credit to the Western Bond & Mortgage Company for the value of the securities already held by the Bank.

Some of the Supporting Evidence:

See Exhibit 28 (Tr. 340) and Exhibit 30 (Tr...
(Testimony of R. Erickson)

“Q. Explain from what you got this information you refer to; what it was.

A. In the files of the Ochoco Farms Corporation there is a memorandum showing the details of the settlement, and I think the notation shows as per Mr. Greenwood's figures of February 17, 1932.

.

A. Yes, they are part of the items that make up the \$28,495.71 which added to \$27,464.29 amount to \$55,960.00." (Tr. 334-7)

"Q. Mr. Erickson, you prepared a memorandum from which you testified yesterday of certain figures.

A. Yes.

Mr. Teiser: Is there any objection to having this marked as an exhibit merely for the purpose of giving to the court the figures more easily, but not for probity, just so the court may have before it the tabulation in understandable form? Is there any objection to that?

Mr. Thompson: No objection to be used to illustrate his testimony.

The paper was introduced and marked Trustee's Exhibit 28." (Tr. 340)

Finding (10) (Continued) (Tr. 75)

. that upon receiving the assignment of said notes and mortgage securing same, the Bank of California, National Association, returned to the Massachusetts Mortgage Company the collateral belonging to the Massachusetts Mortgage Company which the Bank held as security for said advances.

Some of the Supporting Evidence:

(*Testimony of Frederick Greenwood, Branch Manager of The Bank of California*)

"Q. And as a matter of fact that collateral was returned when you accepted the assignment of the mortgage?

A. It was." Tr. 345)

Finding (10) (Continued) (Tr. 75)

. and which was deemed by the Bank sufficient to protect the Bank for said advances made

by it to said Massachusetts Mortgage Company.

Some of the Supporting Evidence:

(Testimony Frederick Greenwood)

“Q. I understand then that the collateral, plus the financial statement of the Insurance Building Corporation and the financial statement of the Massachusetts Mortgage Company and the notes placed as security for these two notes, would to your mind be ample security and be responsible for the payment of these two notes?

A. We regarded that collateral as protecting us temporarily until the transaction could be accomplished.” (Tr. 348)

Finding (10) (Continued) (Tr. 75)

. . . . and also released the debt then owing by the Western Bond & Mortgage Company to it.

Some of the Supporting Evidence:

See Exhibit 22 (Tr. 309)

(Testimony of Thomas G. Greene, Attorney for the Bank)

“A. . . . Mr. O’Flynn then wanted a memorandum in the form of a bill of sale, or otherwise, showing complete release and discharge of the Bank of California of its claim against the Western Bond and Mortgage Company . . . and in pursuance of his request I prepared this draft of bill of sale, and also a release of the Bank’s claim against the Western Bond and Mortgage Company . . . O’Flynn wanted it and he wanted a specific stipulation that the Western Bond and Mortgage Company was released and discharged of its liability on its endorsement on that paper.” (Tr. 396-7)

Finding (11)—(Tr. 75-76)

That as a part of the same transaction, the Western Bond & Mortgage Company also transferred to the Bank of California, National Association, or caused to be transferred to it, twenty certain Idaho Irrigation Bonds of the face value of \$500.00 each, issued by Boundary County, Idaho, Drainage District No. 10, which bonds were at the time of the filing of the petition in bankruptcy the property of the Western Bond & Mortgage Company.

Some of the Supporting Evidence:

See Exhibit 22 (Tr. 309), Exhibit 23-A (Tr. 313) and Exhibit 23-B (Tr. 314).

(Testimony of Miss E. E. Gallagher)

“Q. Miss Gallagher, I hand you the journal of the Western Bond and Mortgage Company, showing journal entry 51583, together with the paper attached, and ask you if that is a part of the journal entries of the Western Bond and Mortgage Company?

A. Yes, that is the journal.

· · · · ·
That is in reference to the Kootenai bonds.

· · · · ·
Q. Miss Gallagher, I ask you whether or not in the files of the Western Bond and Mortgage Company there was a receipt which I have handed you?

A. Yes.

Q. Was that signed by the Western Bond and Mortgage Company?

A. Yes.

Q. That is a receipt for the Kootenai bonds from the Ochoco, as transferred from the Ochoco by O'Flynn, a receipt by O'Flynn for the

bonds which had been transferred from the Ochoco.

A. Yes.

Q. Will you interpret it?

A. 'Sold Ochoco Farms Corp. 1000, they pledge them with Bank of California.' (Tr. 309, 311-12)

See Paragraph X Trustee's petition (Tr. 25-6) and Bank's answer thereto (Tr. 51).

Finding (12)—(Tr. 76)

That (a) the said deed to the Ranch property from the Keystone Finance Company to the Ochoco Farms Corporation, (b) the said release and satisfaction of mortgages by the Western Bond & Mortgage Company to the Keystone Finance Company, (c) the said mortgage securing notes for \$55,960.00 from the Ochoco Farms Corporation to the Massachusetts Mortgage Company, and (d) the assignment of mortgage, securing said notes, from the Massachusetts Mortgage Company to the Bank of California, National Association, were all simultaneously caused to be recorded on the County Records of Crook County, Oregon, on March 2, 1932, by the attorney for the Bank of California, National Association, to whom all of said instruments had been delivered, and who was holding the same in escrow, awaiting the determination by the Bank as to the sufficiency of the value of Russell Ranch adequately to secure the notes of \$55,960.00.

Some of the Supporting Evidence:

See Exhibit 24 (Tr. 26).

(*Testimony Thos. G. Greene*)

“Q. Were these papers recorded by you at the same time and returned to you?

A. They were; they were delivered to me by some representative of the Massachusetts Mortgage Company, probably Mr. O’Flynn, and I sent the whole bunch to the clerk of Crook County, and that is the way my name came to be stamped on the bottom of the original, Return to the office of Thomas G. Greene, instead of the Western Bond and Mortgage Company” (Tr. 415)

Finding (13)—(Tr. 76-77)

That as a result of the assignment of the mortgage securing said notes in the amount of \$55,960.00 the said Bank became the possessor of said notes and mortgage and that the said Bank upon the receipt of said notes and the recordation of the assignment of mortgage securing the notes of \$55,960.00 released the Western Bond & Mortgage Company from the indebtedness which it owed said Bank,

Some of the Supporting Evidence:

See Trustee’s Exhibit 22. (Tr. 309)

See Paragraph IX of Bank’s Answer to Trustee’s Petition to Show Cause (Tr. 49, 50) admitting that it became possessed of said notes and mortgage.

(*Testimony of Thomas G. Greene, Attorney for the Bank*)

“A. . . . Mr. O’Flynn then wanted a memorandum in the form of a bill of sale, or otherwise, showing complete release and discharge

by the Bank of California of its claims against the Western Bond and Mortgage Company . . . and in pursuance of his request I prepared this draft of bill of sale, and also a release of the Bank's claim against the Western Bond and Mortgage Company . . . O'Flynn wanted it and he wanted a specific stipulation that the Western Bond and Mortgage Company was released and discharged of its liability on its endorsement on that paper." (Tr. 396-7)

Finding (13) (Continued)—(Tr. 77)

. . . . and that the Western Bond & Mortgage Company received no other or further consideration from said Bank or from others.

Some of the Supporting Evidence:

(Testimony of R. Erickson)

"Q. . . . I will ask you whether or not the books show that the Western Bond and Mortgage Company received any consideration from the Keystone Finance Company for the satisfaction of these mortgages?

A. The Western Bond and Mortgage Company received nothing from the Keystone Finance Company to satisfy either of these mortgages.

Q. You found no record of any consideration being paid?

A. No record of any consideration being paid." (Tr. 331-333)

Finding (14)—(Tr. 77)

That after the notes secured by said mortgage assigned to the said Bank of California, National Association, became due, the said Bank of California, National Association, foreclosed the said mort-

gage and upon foreclosure sale, bid in the said Russell Ranch at Sheriff's sale held on the 1st day of December, 1933, for \$64,328.30 and at the same time bid in the twenty Boundary County, Idaho, Drainage District No. 10 bonds, foreclosed at the same time, for the sum of \$500.00 and received delivery of said bonds; and that thereafter, the said Bank of California, National Association, received a Sheriff's deed for the said Russell Ranch.

Some of the Supporting Evidence:

See Paragraph XII of Trustee's amended petition for order to show cause (Tr. 27-8) and Paragraph XII of Bank's answer to said petition (Tr. 52-55).

Finding (15)—(Tr. 77)

That the said Bank of California, National Association, ever since December 1, 1933, had and now has possession of said bonds and of said Russell Ranch.

Some of the Supporting Evidence:

Same as Finding (14) above.

Finding (16)—(Tr. 77)

That the Bank of California, National Association, had actual knowledge, prior to the receipt of the notes aggregating \$55,960.00 and prior to the assignment of mortgage to it securing said notes and prior to the executing and recordation of the instruments referred to in Finding No. 12, of the filing of the petition in bankruptcy against the Western Bond & Mortgage Company,

Some of the Supporting Evidence:

(Testimony Thomas G. Greene)

“Q. You were attorney for that bank when the transactions with the Western Bond and Mortgage Company and the Massachusetts Mortgage Company were negotiated which is the subject of inquiry today?

A. Yes.

Q. You were attorney for them in February, 1932?

A. Yes.

Q. Will you state whether or not at the time you were attorney for the Bank in this connection in February, 1932, and at the time these negotiations were initiated and negotiated you had knowledge of the fact that the Western Bond and Mortgage Company had an involuntary petition in bankruptcy filed against it?”

“ . . . Certainly I did.” . . . (Tr. 251)

(Testimony of Herbert E. Alward)

“Q. And he was your representative in the matter?

A. Mr. Greene at that time and since has been the attorney we have used when we have needed legal advice and assistance.

Q. And whatever information he had you were satisfied to take?

“ . . . Mr. Greene: They had all the information I had.” (Tr. 369-370)

See also Trustee's Exhibit 31 (Tr. 414).

Finding (16) (Continued) (Tr. 77-78)

. . . . and had actual knowledge at and prior to said time of the ownership by the Western Bond & Mortgage Company of the notes given by the Key-

stone Finance Company in the amount of \$77,500.00 and of \$72,500.00, and of the ownership of the two first lien mortgages upon the said Russell Ranch to secure the payment of said notes, and of the recordation thereof; and that said Bank, also at said time, had knowledge of the fact that the recordation of the satisfaction of the mortgages held by the Western Bond & Mortgage Company and the recordation of the mortgage to the Massachusetts Company and the recordation of the assignment of that mortgage to it would supplant in its favor the first mortgage lien held by the said Western Bond & Mortgage Company upon said Russell Ranch, and accordingly would deprive the Western Bond & Mortgage Company of its property rights in said Ranch;

Some of the Supporting Evidence:

See Exhibits 24 and 25 (Tr. 261)

(Testimony of Thomas G. Greene)

“Q. You did know that the property that you were about to take a mortgage on was property that the Western Bond and Mortgage Company held mortgages on at the same time?

A. How could I help knowing it when the abstract showed it. Of course I knew it. . . . (Tr. 267)

Q. Mr. Greene, when you examined this title—you did examine the title, did you not?

A. I examined the title.

Q. As to the Russell Ranch?

A. Yes.

Q. Before the assignment was taken you

had the abstract before you?

A. Yes.

Q. And at that time, . . . there appears to be recitation of the facts that the Keystone Finance Company, an Oregon corporation, had executed a mortgage to the Western Bond and Mortgage Company for seventy-two thousand five hundred dollars, and another mortgage from the Keystone Finance Company . . . for seventy-seven thousand five hundred dollars?

A. That is correct.

Q. And that was apparent in the abstract?

A. It was.

Q. The abstract also showed, . . . did it not, that under date of February 13, 1932, these two mortgages had been satisfied by two satisfactions of mortgages, dated as I said, February 13, 1932, and recorded March 2, 1932?

A. . . . I know, as a matter of fact, that was done, I saw the resolution.

Q. The abstract also shows a deed from the Keystone Finance Company, an Oregon corporation, to the Ochoco Farms Corporation, dated February 13th and recorded March 2, 1932, of the property covered by the mortgages and the satisfactions of mortgage; is that right?

A. Yes. . . . That is what it shows." (Tr. 256-9)

"Q. There is also shown in this abstract a mortgage from the Ochoco Farms Corporation to the Massachusetts Mortgage Company upon the same property, the Russell Ranch, to secure a note of \$55,960.00 which was dated February 13, 1932,, and filed and recorded on March 2, 1932?

A. Yes that appears to be in there also, and

I think I saw that too before it was put on record." (Tr. 260-1)

"A. My recollection is these instruments were delivered at the same time; they were executed at different dates. The execution of the assignment of the Massachusetts Mortgage Company to the Bank of California was subsequent." (Tr. 259)

Finding (16) (Continued) (Tr. 78)

. . . . and that the said Bank also had actual knowledge of the true character of the Keystone Finance Company in relation to the said Western Bond & Mortgage Company as set forth in Finding No. 3;

Some of the Supporting Evidence:

See Exhibit 30 (Tr. 413)

See Exhibit 31 (Tr. 414)

(Testimony of Thomas G. Greene)

"Q. You say you went up to the court to hear these lawsuits?

A. I did not hear any of the suits. I heard arguments.

Q. Did you examine the papers in the cases at all?

A. Some I did. . . .

The Court: Where were these suits you refer to?

A. One was commenced in March, 1931, and the other one in April, 1931, the principal one I think. There were four or five others.

.
Q. Why did you go up to hear the arguments?

.

A. Because the Bank of California was trying to get some additional security from the Western Bond and Mortgage Company.

Q. Did you know of this suit against the Western Bond and Mortgage Company brought by Allen McCurtain?

A. Yes, that was one of them.

Q. And another brought by Carl Little?

A. Yes.

Q. And the John Brocker suit brought in the United States District Court?

A. Yes.

Q. Don't you know that the charge was made in that suit that the Keystone Finance Company was a mere dummy of the Western Bond and Mortgage Company?

A. I didn't know it was charged in the complaint. I heard it, I think from some lawyer up there." (Tr. 402-4)

Finding (16) (Continued) (Tr. 78)

. . . . and of the ownership by the Massachusetts Mortgage Company of all of the stock in the Western Bond & Mortgage Company.

Some of the Supporting Evidence:

(Testimony of Mr. Greenwood)

"Q. I think you have a statement here that the Massachusetts Mortgage Company owned all of the common stock of the Western Bond and Mortgage Company. You knew that of course, didn't you?

A. Apparently we did, yes." (Tr. 349)

Finding (16) (Continued) (Tr. 78)

. . . . and of the interlocking character of the officers of the various companies, as also set forth in Findings No. 3.

Some of the Supporting Evidence :

See various instruments filed as Exhibits in this cause bearing the signatures of the identical individuals as officers of the various companies, all of which were held by Mr. Greene under escrow and which were recorded by him.

Finding (17)—(Tr. 78-79)

That as a result of the transactions heretofore detailed the said Western Bond & Mortgage Company, and the estate in bankruptcy thereof, after the filing of the petition in bankruptcy herein, was depleted of its property in the said Russell Ranch and of its first mortgage liens thereon, and of its property in said \$10,000.00 par value Boundary County, Idaho, Drainage District No. 10 Bonds.

Some of the Supporting Evidence :

See as to the fact that the Bank of California obtained the Russell Ranch and the bonds, admissions in Paragraph XI of the Bank's Answer to trustee's petition for order to show cause, wherein it is said:

“. . . . and further answering the same says that the *acceptances by respondent* for a valuable consideration of the assets hereinabove mentioned” (Tr. 51-2)

And as to the depletion phase of this finding, see testimony of Certified Public Accountant, Erickson, set forth in supporting evidence under Finding 13 (continued) to the effect that the books showed no consideration received by the Western Bond & Mortgage Company for the transfer or relinquishment of its interest in these properties.

Also see Diagram, p. 13 of this brief.

Finding (18)—(Tr. 79)

That the value of said Russell Ranch on December 1, 1933, the time said Bank of California, National Association, obtained possession thereof, was \$65,000.00.

Some of the Supporting Evidence:

(Testimony of Frederick Greenwood)

"We had an inspection made of the Russell Ranch, and ascertained the reasonable value of that property." (Tr. 344)

(Testimony of William Kennedy, specialist in property management and appraisements.)

"Q. Did you at the request of the Bank of California make an appraisal of what is known as the Russell Ranch in eastern Oregon in December, 1930 or January, 1931?

.
A. As I recall it now it was in January, 1932.

.
Q. What valuation did you put on it?

A. I valued it at from \$64,500.00 to \$65,000.00." (Tr. 386)

Finding (18) (Continued) (Tr. 79)

. . . . and that the value of the said Drainage District Bonds on December 1, 1933, when said Bank of California, National Association, obtained possession of them, was \$1,000.00.

Some of the Supporting Evidence:

See Paragraph XIII of the Bank's answer to trustee's petition for order to show cause, wherein it is said:

“ . . . and denies that the value of said Drainage District Bonds on or about February 13, 1932, was \$5,000.00, or any other or greater sum than \$1,000.00” (Tr. 55)

Finding (19)—(Tr. 79)

That the estate in bankruptcy of the Western Bond & Mortgage Company was diminished to the extent of the value of said Russell Ranch and of the value of said Bonds and that said diminution occurred after the filing of the petition in bankruptcy to the knowledge of the Bank of California, National Association.

Some of the Supporting Evidence :

See supporting evidence to Finding (17).

Finding (20)—(Tr. 79)

That no present consideration, fair or otherwise, was paid by the Bank of California, National Association, for the said Russell Ranch or for the said Drainage District Bonds.

See Certified Public Accountant Erickson's testimony under supporting evidence to Finding 13 (continued), p. xxii this Appendix.

Finding (21)—(Tr. 79)

That said transactions in relation to said Russell Ranch and to said Drainage District Bonds was a transaction out of the ordinary course of business of said Western Bond & Mortgage Company and of said Bank of California, National Association.

Some of the Supporting Evidence :

See report of Mr. Alward to the Home Office of the Bank, Exhibit 30 (Tr. 413) and see letters Exhibit 29 (Tr. 379).

The fact that the transaction was carried on the books of the Bank under the heading "Westco Finance Co." (Tr. 380-1)



